1986-1987 BUDGET

Budget Speech
and Additional Information

Québec

86-06166/

1986-1987 BUDGET

Budget Speech and Additional Information

Delivered before the National Assembly
by Mr. Gérard D. Levesque,
Minister of Finance,
on May 1, 1986

Gouvernement du Québec
Ministère des Finances

ISSN 0481-2654
ISBN 2-551-08710-4

Legal Deposit, 2nd quarter, 1986
Bibliothèque nationale du Québec

Table of Contents

Budget Speech ..... Budget

Fiscal and Budgetary Measures ..... Appendix A

Medium-term Outlook on the Québec Government's Financial Position ..... Appendix B

Changes in Accounting Policies ..... Appendix C

Review of the Economic Situation in 1985 and Outlook ..... Appendix D

The Government's Financial Position and Borrowings in the Public Sector ..... Appendix E

Fiscal Arrangements: Contracting-out by the Federal Government? ..... Appendix F

Budget Speech

Introduction 1

Getting the Québec economy moving again 2

The situation 2

Direction to be taken 3

Action with regard to business firms 3
— Employee-employer cooperation 4
— Creation of new business firms 4
— Measures for concordance with federal taxation 5
— Assistance for the capitalization of corporations 5

Measures affecting individuals 6

Deregulation 7

The role of government corporations 8

Reestablishing order in government finances 8

Reestablishing balance 9

Reducing expenditure 11

Consequences of the reduction in federal transfers 12

Reform of accounting and elimination of financial problems 13
— Hospital deficits 14
— Bad debts 14
— Losses of government corporations to be assumed 14
— Reform of accounting policies 15

Increased recourse to fees 16

Tax expenditures 17

Local governments 17

Other measures 18
— Fuel and cigarettes 18
— Taxation of various types of energy 19
— Measures to assist the regions 19

Financial framework 20

Conclusion 22

Introduction

In the past few months the people of Québec have heard a great deal about the state of Québec's public finances. They are equally concerned about the condition of the economy. Some are, I know, anxiously awaiting the measures which will be announced tonight with a view to finding solutions to the budgetary gap of a billion and a half dollars for the 1986-1987 fiscal year. These measures, together with those put into effect by the government since last December, will set us on the right path toward a lasting recovery of the government's financial health. Such recovery is an essential prerequisite for giving new life to Québec's economy and assuring the social progress of our people.

Last December 18, I submitted to this Assembly a budgetary policy statement whose objective was to make our economy more competitive and our tax system more equitable. In accordance with the commitments made during the election campaign, I announced at that time that there would be a substantial reduction in personal marginal income tax rates, an exemption from the sales tax for premiums on certain types of insurance and a drop in fuel tax in the outlying regions.

$81 000 000 reduction in the 1985-1986 budget deficit

Although the government was faced with a delicate financial situation, I nevertheless announced that we would take whatever steps were necessary to reduce the 1985-1986 budget deficit by comparison with that of the preceding year. I am happy to announce this evening that we have met this commitment: the 1985-1986 budget deficit will amount to $3 152 000 000, a drop of $81 000 000 in relation to 1984-1985. We succeeded in this despite the federal government, which refused to pay us the $66 000 000 which we continue to claim as our just entitlement in supplementary equalization payments.

Last March 5, I submitted to the people of Québec a document describing the state of Québec's public finances. I concluded then that there was an urgent need for immediate action to rectify the situation. The deficit could simply not be allowed to rise to close to $4 500 000 000 in 1986-1987. Nor could we continue to finance a substantial part of our current expenditures by borrowing, that is, borrowing to pay the grocery bills! Moreover, it was essential to solve a series of financial problems accumulated over the years by the former government.

Expenditure cut back by more than $1 000 000 000 in 1986-1987

In the last months, therefore, we have carried out a rigorous analysis of expenditures. The Chairman of the Conseil du trésor was able to announce, at the end of March, cuts and reductions in estimated expenditures of over $1 000 000 000 for 1986-1987.

$257 000 000 drop in the budget deficit in 1986-1987

Because of the various fiscal and budgetary measures I shall describe, I am happy to announce this evening that our efforts have borne fruit. The government's budgetary deficit will fall in 1986-1987 for a second consecutive year, to $2 895 000 000. This represents a $257 000 000 reduction in relation to the previous year. Such performance can be considered as excellent, especially in view of the fact that the transfer payments from the federal government will be reduced this year. This result, which takes into account the reform of certain inappropriate accounting practices, will be accomplished at the same time that we solve the government's accumulated financial problems.

But our work does not stop there. We must continue our efforts to clean up Québec's public finances in the coming years. The action we take will clear the way, allowing us to work vigorously toward the recovery of the Québec economy and strengthening its industrial structure.

400 000 jobs to be created by 1990

This is our true objective, which means we must substantially reduce the unemployment rate by creating 400 000 jobs in Québec between now and 1990. I am announcing this evening a number of measures that will enable us to approach this goal, even though much will remain to be done before our purpose is achieved. After coping with this year's budgetary gap and cleaning up government finances, we intend to devote all our energies to this task.

Getting the Québec economy moving again

The situation

In 1985, the Québec economy continued the recovery begun in 1983. Growth in domestic production should be about 4.0% in 1985, as compared with growth rates of 3.1% in 1983 and 5.2% in 1984.

Québec's economic growth to be sustained

During this time, the Canadian economy achieved much the same results, i.e., 2.7% in 1983, 4.9% in 1984 and 4.3% in 1985. As for the American economy, initial recovery was promising, but by 1985 it was showing signs of exhaustion with a growth rate of only 2.2%. Québec is therefore maintaining its position in relation to its principal trading partners.

But this is not good enough. And I feel sure that the people of Québec do not consider it adequate. Québec was more affected than others by the 1981-1982 recession, and it had to catch up. A team that is losing at the beginning of a match must not congratulate itself if it subsequently plays just as well as its opponents. The unemployment rate is 7.2% in the United States. In Canada it is 9.6%, in Ontario, 6.8% and in Québec, 11.8%. We cannot accept such a situation.

Unemployment

An average rate of unemployment of 12% in Québec means 18% unemployment among young people from 15 to 24. And this means that in certain regions the rates may exceed 20%. It is also an indication that, three years after the beginning of recovery, the number of social aid recipients able to work continues to go up. This is an untenable position and a waste of human resources. This is why our government has set itself the objective of creating 400 000 jobs between now and the end of the decade.

Investment

To grasp the magnitude of the task awaiting us, we have only to consider the level of investments in Québec. Our total investments represent only 17% of gross domestic product. For all the OECD countries, the rate varies between 20% and 22%, and rates over 25% are not uncommon. The drop in public investment over the past few years is not the only cause of this inadequacy. There has also been a disturbing decrease in private, non-residential investment. Although such investment represented 8.8% of GDP from 1970 to 1975, it was only 7.8% in 1985. The rate for this type of investment was 8.8% in Ontario. Inadequate investment does not bode well for the future.

If nothing is done to change the way things are going, our estimates, like those of other agencies who produce economic forecasts, show that the situation will not improve in any appreciable way in the next four years. Economists in my department estimate that, even if things continue at the same pace in the years to come, employment will only go up by slightly more than 2% per year, barely keeping pace with the labour force, so that the unemployment rate will not go much below 10% in Québec in 1990. We have to roll up our sleeves and resolutely tackle the problem without delay.

Direction to be taken

The very first thing that must be done, if our reaction is to be worth anything, is to realize what profound changes are in the process of coming about economically on a world scale. As tariff barriers disappear one by one in international trade, and the electronic revolution wipes out the distance between continents, the developing countries are trying to attain for themselves the privileged ways of life they see elsewhere.

Québec, whose past economic development depended in part on exploitation of its natural resources and its relatively cheap labour, must act now if it wishes to carve out a place for itself in a world where the competition is increasingly fierce.

There is no doubt that some of our natural resources are still not being exploited to the maximum; our hydroelectric resources are a case in point. But it is, above all, on our human resources that we must depend to a large extent. After considerable efforts to catch up, we now have a much better trained and educated population than we had before. Our universities and our researchers are reaching world standards of excellence. We have also developed a class of entrepreneurs that are extremely aggressive and capable of competing at the highest levels. Our knowledge, our know-how and our innovative capacities place us in the front rank. We must now put this talent to good use.

In order to make the most of our advantages, it will be necessary to create a new climate in Québec. Workers and business will have to work together if we are to succeed. Many things must change. The size of business firms will have to be optimized; greater stress must be placed on the search for more efficient methods, both in manufacturing processes and in management methods and the search for markets. We must develop financial structures that will allow business firms to take greater risks so that they can take maximum advantage of market possibilities. In such a context, the management of human resources will have to change. If employees are content to put in their hours without having the opportunity to contribute actively to the firm's success, we will miss the boat.

The State must also adapt. Government budgets have assumed unprecedented proportions thanks to the economic expansion that has been going on for half a century. Parallel with this, social pressures have prompted the legislator to intervene in an increasing number of sectors without anyone becoming unduly perturbed about the consequences for the economy of this plethora of laws and regulations. But in the face of today's challenge — that of carving out a place for ourselves in world affairs — all our energies will have to be mobilized, including those of the State. In Québec we have pushed the development of the State a little farther than elsewhere. Adaptation will therefore be a rather delicate matter.

Change will have to come about first in three important government instruments: fiscal and budgetary policies, laws and regulations, and action by government corporations. I shall now present what we intend to do with regard to each of these three aspects of government action, dealing separately with fiscal and budgetary action in its corporate and personal aspects.

Action with regard to business firms

Financial relations between business firms and the Québec government are extremely important and diversified. On the one hand, Québec firms contribute more than six billion dollars to the Québec public sector; on the other, overall assistance the government gives them totalled $700 000 000 in 1985-1986,

without taking into account that from the federal government and amounts obtained through the use of tax shelters.

We may well wonder whether all this is properly adapted to today's realities. It is obvious, for example, that the majority of assistance programs, whether budgetary or fiscal, were set up piecemeal to deal with specific problems, without any great concern for the coherence of the whole set of programs. We should also give some thought to whether or not our help is really going to the industrial sectors or aspects that have most impact on economic growth. Have we not had too great a tendency to subsidize firms that are failing and to demand too much of those that are succeeding? Is there not a risk that those who ask the State for grants will become lost in the intricacies of bureaucracy?

A review is called for

These are the matters we must investigate, globally and in depth. And I would add that they are urgent. My first task on arriving at the ministère des Finances was to put order into government finances. This Speech gives concrete results as well as a clear, precise plan of action in this matter. I also intend to tackle, in conjunction with my colleagues from the economic mission, the question of updating our fiscal and budgetary policy respecting business firms.

Right now, however, it is important to introduce certain specific measures. We must first find the means of promoting greater cooperation between employees and employers in business firms. Secondly, we must give more effective fiscal support to new enterprises. Thirdly, certain steps have to be taken to harmonize our taxation system with that of the federal government. And finally, some adjustments must be made in our system of aid for capitalization.

— Employee-employer cooperation

It is clear that the most successful firms are those which know how to get the best from their employees, in terms of creativity, effort, motivation, and all their other resources. There are many ways in which employee-employer cooperation can be developed, and it is up to the firm to use the method best suited to its situation. However, fiscal policy can help by encouraging employees to become shareholders in their own firms. I intend to take action to this effect in this budget.

25% deduction for purchase of shares by employees

As of the 1986 fiscal year, employees who subscribe to their employer's share issues which are eligible for inclusion in the Québec Stock Savings Plan (QSSP) and the sociétés de placements dans l'entreprise québécoise (SPEQs) will be able to benefit from an additional tax deduction equal to 25% of the purchase price of their shares. This deduction will be additional to that to which they would be entitled under the Québec Stock Savings Plan in the case of a public issue, or to the advantage derived from the sociétés de placements dans l'entreprise québécoise (SPEQs) if it is a private issue. The Appendix on Fiscal and Budgetary Measures, which is an integral part of this Speech, explains the mechanism to be used and the conditions that must be met to benefit from this fiscal advantage.

— Creation of new business firms

Three-year tax holiday

We must encourage the creation of new business firms in Québec. Launching a business entails risks, often enormous. But at the same time jobs are created for young people as well as for the unemployed of all categories. I therefore intend to lighten the tax burden of new companies. To this end, any corporation or cooperative constituted after midnight tonight will be exempted from corporate income tax and tax on the capital of corporations for the first three taxation years. Exemption will of course be reserved for small enterprises and the first

two hundred thousand dollars in taxable income will be exempt from the tax on profits, and the first two million dollars in paid-up capital will be exempted from the capital tax.

Settling of young farmers

I also want to offer special support to young people who wish to establish themselves as farmers. The government is aware of the importance of agriculture in Québec and of the considerable amounts young farmers must invest to create a new business in this sector. A farm development program already exists at the ministère de l'Agriculture, des Pêcheries et de l'Alimentation and $5 000 000 in appropriations have been allocated for 1986-1987. To improve this program, I am announcing that the grant for young farmers who settle will be increased from $8 000 to $15 000. Consequently, appropriations will be raised by $7 000 000, to $12 000 000. The Minister of Agriculture, Fisheries and Food will make public the details of improvements which have been made.

— Measures for concordance with federal taxation

Last year, the federal government adopted two important measures concerning business and investment taxation. One concerned exemption from capital gains and the other, a new method of taxing dividends.

Capital gains exemption

The federal government introduced a lifetime capital gains exemption last year. In June 1985, the Québec Minister of Finance said that he had some reservations about this measure and intended to discuss it with his federal colleague; at the same time he stated that Québec taxation would be brought into line with the federal in this matter, but only for 1985 and 1986.

Discussions with the federal government have not resulted in its changing its policy one iota. If nothing is done, Québec will find itself with a differential in the tax treatment of capital gains with the other provinces. This Québec cannot afford: it would only be a repetition of the sad story of succession duties. I am therefore announcing this evening complete harmonization in this matter.

Dividend taxation

The federal government has changed its system of taxing dividends, to begin in January 1987. It has abolished the tax on dividends paid by small business firms; on the other hand, it has increased the tax paid by individuals on dividends received from large and small firms alike. The purpose of the change was to simplify the tax structure and preserve the principle of integration of corporate and personal taxes.

As we know, the nine other provinces will be forced to adopt similar taxation methods. It does not seem desirable for Québec to maintain a different system for taxing dividends. We are therefore going to bring our taxation system into line on this point as well.

Finally, this Speech contains other measures to bring Québec's taxation system more into line with the federal system. These will be discussed in the Appendix on Fiscal and Budgetary Measures.

— Assistance for the capitalization of corporations

For some time, there has been talk of the problems firms encounter in obtaining sufficient capital. This is an essential condition for their development, as a company must be able to quickly seize opportunities and assume the risks inherent in them.

Québec has already adopted several methods of intervening (Québec Stock Savings Plan, sociétés de placements dans l'entreprise québécoise (SPEQs), cooperative investment plan, capitalization loans, and the program for facilitating share issues by small and medium-sized businesses). The ministère des

Finances is constantly monitoring changes in these programs with a view to evaluating their performance. To ensure that the proceeds of share issues combined with tax benefits are oriented more toward the creation of concrete economic activities which create jobs, assistance for the capitalization of corporations will be tightened up. With respect to the Québec Stock Savings Plan, the introduction of penalties for the redemption of shares, the disqualification of investment corporations, and restrictions on share issues which do not comply with the spirit of the QSSP are among the principal measures which should reduce its cost while maintaining its efficiency. The Appendix on Fiscal and Budgetary Measures contains details of measures to tighten up these programs.

Assistance program modified

One concerning the financial assistance program facilitating share issues by small and medium-sized business requires some explaining. The first phase of this program covers the reimbursing of costs related to feasibility studies of a first public share offering, while the second provides for a grant of up to $400 000 covering the actual share issue.

For some time, the market for new shares in Québec has been very active. In 1985, the number of firms making such offerings doubled in relation to the two preceding years. Since the capital market now seems much more open to our enterprises, it seems reasonable to abolish the second phase of the program facilitating share issues by small and medium-sized businesses as it is no longer necessary to encourage such issues. However, we will continue to subsidize feasibility studies covering first public share offerings.

The idea of establishing a "QSSP Investment Fund" was favourably received. The Fund was designated to enable individuals to benefit from the advantages of the Québec Stock Savings Plan, while diversifying their portfolios and minimizing risks.

In recent months, we have continued consultations on this matter and our investigation has not been conclusive on the advisability of introducing such a program at this time. Consequently, I wish to inform concerned parties that the ministère des Finances will attempt to harmonize various points of view in the coming months, in order to reach a final decision.

Measures affecting individuals

Changes in the economy do not depend upon businesses alone, but on individuals, who are an important driving force in the economy. Their involvement determines to a large extent the volume of investment and the creation of long-term employment.

Taxation and transfers covering individuals appreciably affect their motivation and determination to participate in economic development. In this respect, a taxation system which taxes labour too heavily may encourage them to withdraw from the labour market, or work on the underground market, or even leave Québec to avoid the disadvantages of the taxation and transfer system.

Our government is quite aware of problems which may arise in this respect. For this reason, we have not hesitated, despite the precarious financial position we inherited from the previous government, to speed up the reduction in tax rates for taxpayers whose taxable income is over $17 364. We have also reduced the fuel tax and the sales tax on insurance premiums.

Thorough reform of social aid

Moreover, we have undertaken the necessary reform of social aid. The program has inherent in it problems of fairness, arising primarily from the fact that beneficiaries under 30 are treated differently from those over 30. The incentive to work is another problem, partly attributable to the structure of benefits, and partly to the underdevelopment of programs designed to encourage

beneficiaries to find work. It must be acknowledged that the fact of treating on the same footing beneficiaries who can, and cannot, work does not make things easier. Program costs are high. As proof, Québec accounts for 40% of social aid benefits paid in Canada. Moreover, these costs continue to rise more rapidly than inflation, even during economic recovery.

The Minister of Manpower and Income Security is currently preparing a thorough reform of this program. Of course, the personal tax system will have to avoid obviating the reform's benefits.

On the other hand, despite the drop in tax rates announced last December, the personal tax system is still not completely competitive. Certain categories of low-income Québec taxpayers pay lower taxes than in Ontario, although others pay much more. Overall, the tax burden of Quebecers is one billion dollars higher than it would be in Ontario; the additional burden is accounted for entirely by income tax. Some people maintain that Québec society's particular characteristics justify heavier government spending and a greater tax burden, i.e., the cost of preserving Québec's unique character. Even were this the case, I do not believe that it would be appropriate to finance our special features through higher taxes on production activities.

Taxation system

The marginal tax rate structure causes other problems. It encourages low-income earners to withdraw from the labour market, and leads the middle and upper classes to reduce employment income. It encourages underground workers and tax evasion. It reduces the monetary advantage of seeking education and upgrading training. In a word, it strongly hinders the productive capacity of the Québec economy.

Finally, the personal income tax structure presents serious problems of equity between the various categories of taxpayers. Most of them support higher tax rates in order that certain others, more affluent, may avoid taxation by using all sorts of tax shelters. In the current consumer tax structure, a large number of goods and services are exempted, which puts consumers of taxable goods at a disadvantage. To solve all of these problems, we must envisage major changes in the personal taxation system.

We may have to broach these questions much sooner than we think, as the federal government is seriously considering the possibility of introducing a tax on transactions, i.e., a type of value added tax. Such a proposal might take Canada as a whole a long way toward reforming consumption taxes and a new distribution of this taxation field, currently largely under provincial control. Discussion has yet to begin, but it is in our interest to start thinking about it now.

Deregulation

Aside from budgetary and fiscal policies, the government most strongly influences economic activity through legislation and regulations. It is far from certain that the situation in this respect is satisfactory.

Too often, successive governments have intervened in a piecemeal fashion to solve a particular problem without being overly concerned about the effects their actions have on the competitiveness of certain sectors, or even the economy overall. They have conferred extensive powers on agencies such as the Commission de la santé et de la sécurité du travail, the Commission des transports and many more, which are scarcely accountable to the public. Directives, regulations and red tape have proliferated, with the result that ordinary Quebecers and business firms have difficulty finding their way through the maze.

Our government has concluded that the task to be undertaken is not so much a question of seeking to regulate better, but of regulating less. Therefore, we have established a committee on deregulation under the authority of the Minister of Justice and directed by the Prime Minister's Parliamentary Assistant. This committee has already met and the first results of its deliberations should be announced soon. The goal we are pursuing is to free economic agents from an often unacceptable encumbrance and provide them with even more opportunities to contribute thereby to economic development.

The role of government corporations

Government corporations are another vehicle enabling a government to involve itself in economic development. In Québec, they have been used extensively over the past 25 years. In particular, they have provided French-speaking Quebecers with the means of establishing themselves more quickly in major firms which, by dint of history, they had neglected.

Privatization of some government corporations

Today, it is clear that the role of government corporations in Québec's economic development no longer has to be as extensive. There now exists a class of dynamic, competent, well established French-speaking entrepreneurs which is able to take over from the government and which aspires to take on more and more responsibilities in the economic development of Québec. The increasingly urgent need for businesses to be more and more competitive must lead us to bank increasingly on the private sector. My colleague, the Minister responsible for Privatization, has already tabled a document on privatizing government corporations, in which he explains the underlying principles which will guide him and the steps he intends to follow in reviewing their role.

The first phases have already been completed. SOQUIA has divested itself of its shares in Provigo, and the Raffinerie de sucre du Québec is about to be sold. Steps to privatize Quebecair and part of the assets of SOQUEM have been initiated. The privatization of government corporations is well under way. During the coming year, the relevance of maintaining other assets will be reevaluated. I am counting on revenue totalling $175 000 000 in the course of the 1986-1987 fiscal year.

Reestablishing order in government finances

On several occasions, I have mentioned the financial position we inherited when we took power last December. Allow me to return to this question to better situate initiatives launched by the government in recent months, and specify the policy directions we intend to pursue in the coming years.

Troubling situation

The situation described in the pre-budgetary document published last March 5 was extremely troubling. Had the government done nothing to remedy the situation, the budget deficit would have literally exploded in 1986-1987, reaching some $4 300 000 000, without taking into account the impact of measures set out in the December Government Budgetary and Financial Policy Statement.

Troubling, too, because it did not in any way correspond to the picture presented in the April 1985 Budget Speech. At that time, the anticipated deficit for 1986-1987 was $2 970 000 000, but this forecast was not very solid. First, it assumed that the government would effect $455 000 000 in budget cutbacks in 1986-1987, although no such announcement was made to Quebecers. Several weeks after the Budget, the government abandoned cutbacks it intended to achieve in 1985-1986 and added new budgetary outlays. Moreover, it predicted substantially higher expenditure for 1986-1987, barely a few weeks after the Budget Speech.

Indeed, in late May 1985, the government knew that the forecast deficit in 1986-1987 was not $2 970 000 000, but $4 232 000 000. The government knew this, but Quebecers were unaware of the fact.

The government's financial position was troubling, too, because it comprised three additional financial problems which estimates did not take into account, i.e., the $260 000 000 operating deficits hospitals had accumulated since 1982-1983; $700 000 000 in bad debts at present, including nearly $600 000 000 in the ministère du Revenu alone; and losses to be assumed with respect to a number of government corporations.

That is why I decided it was essential to give Quebecers the full picture of the government's financial position, to enable them to realize the urgency of remedying the situation.

The debt has tripled in six years

The truth is that for years, the government has been borrowing to pay for part of the groceries. Moreover, the debt is much too high: it has almost tripled in six years, from $10 700 000 000 in 1980, to $30 000 000 000 at present. The truth is that the government is allocating a growing portion of its revenue to servicing the debt: in 1979-1980, it devoted 7.3% of revenues to this end; this year, the figure will be 13.9%.

Under the circumstances, the government had to act. It has decided to regain control of expenditures and the deficit, to restore order to government accounting practices and solve the problems it inherited from the previous government.

Reestablishing balance

Let us first consider results for the 1985-1986 fiscal year. The April 1985 Budget Speech estimated the deficit for the fiscal year ended March 31, 1985 would total $3 095 000 000. As at September 30, 1985, the anticipated deficit had been raised to $3 235 000 000.

In the December 1985 Government Budgetary and Financial Policy Statement, I predicted that, despite the reductions in income taxes I had just announced, the deficit would drop in 1985-1986, reaching $3 145 000 000.

1985-1986 budget deficit: $3 152 000 000

Information currently available allows me to estimate that the deficit will total $3 152 000 000, despite Ottawa's refusal to grant Québec the $66 000 000 in equalization payments it owes the province for 1985-1986. I will discuss this problem in greater detail later. For the time being, it is sufficient to point out that the deficit is $81 000 000 lower than it was in 1984-1985.

STATEMENT OF FINANCIAL TRANSACTIONS
SUMMARY
(in millions of dollars)

	1984-1985	1985-1986		
		Budget Speech 1985-04-23	Budget Statement 1985-12-18	Preliminary Results
1. Budgetary transactions				
Revenue	+22 310.0	+24 155.0	+24 055.0	+24 078.0
Expenditure	−25 542.5	−27 250.0	−27 200.0	−27 230.0
Deficit	− 3 232.5	− 3 095.0	− 3 145.0	− 3 152.0
2. Non-budgetary transactions				
Investments, loans and advances	− 171.8	+ 120.0	+ 150.0	+ 168.2
Retirement plans account	+ 1 183.5	+ 1 335.0	+ 1 300.0	+ 1 266.5
Other accounts	+ 218.8	+ 40.0	− 20.0	+ 20.4
Balance	+ 1 230.5	+ 1 495.0	+ 1 430.0	+ 1 455.1
3. Net financial requirements	**− 2 002.0**	**− 1 600.0**	**− 1 715.0**	**− 1 696.9**
4. Financing				
Change in cash position	− 211.0	—	− 70.0	− 13.6
New borrowings	+ 3 281.0	+ 3 140.0	+ 2 990.0	+ 2 992.6
Repayments of borrowings	− 1 068.0	− 1 540.0	− 1 205.0	− 1 282.1
Total	**+ 2 002.0**	**+ 1 600.0**	**+ 1 715.0**	**+ 1 696.9**

N.B.: A (−) sign indicates a financing requirement and a (+) sign, a source of financing. For the change in cash position, a (−) indicates an increase, and a (+) sign, a decrease.

What about the current year? In the pre-budgetary document I published last March, I set the budget gap at $1 505 000 000 for 1986-1987. Had we done nothing to solve the problem, it would have been $4 475 000 000, which is a far cry from the $2 970 000 000 forecast in the April 1985 Budget Speech. Last March, I announced that the government could not let the deficit increase to such a level and that it would take steps to solve the problem.

Importance of reducing the deficit

Why can we not allow the deficit to rise to $4 000 000 000, instead of cutting expenditures or increasing revenues? To answer this question, I would like to draw your attention to the following facts. As you know, the Québec government's deficit has been about $3 000 000 000 since 1980-1981. Had the deficit totalled $1 000 000 000 over the past six years, that is, had it been at a level corresponding more or less to the government's annual capital expenditures, Québec's debt would be $12 000 000 000 lower than the $30 000 000 000 at which it now stands. Debt servicing in 1986-1987 would be $1 200 000 000 lower than the estimated total of $3 600 000 000. The question we must ask is this: Would we need to cut expenditures as much this year had we lived within our means over the past six years? The answer is evident.

It is obvious that the difficult economic situation in recent years was partly responsible. However, it must be understood that when the government creates a deficit, there is nothing magical about it. The problem does not vanish; it is simply displaced in time. If it is not solved, it will grow from year to year.

As a result of last year's $3 152 000 000 deficit, additional interest payments will total more than $300 000 000, which must be paid this year and in coming years until the debt is paid off. This means that a growing portion of our revenues must be used to finance past expenditures. Obviously, we have to reduce the deficit.

Reduction in anticipated expenditure in 1986-1987

The Chairman of the Conseil du trésor and I have focused many of our efforts on this task in recent months. More than $1 000 000 000 in cutbacks and reductions were announced when 1986-1987 estimates were tabled, as well as new expenditures totalling $204 000 000 to solve a number of urgent problems, especially in hospital emergency services. Spending cuts enabled us to lower by $806 000 000 the $1 505 000 000 budgetary gap.

1986-1987 budget deficit: $2 895 000 000

There remained a balance of $699 000 000 to be dealt with and we did deal with it. The 1986-1987 budget deficit will be $2 895 000 000, which is $75 000 000 less than forecast.

Current account balanced

This is the first time since 1980-1981 that the deficit has been below $2 900 000 000; it is also the first time since 1977-1978 that the current account balance, i.e., the deficit calculated excluding capital expenditures and the government's contributions to civil service retirement plans, will be balanced. I would like to point out that the balance showed a deficit of more than $1 000 000 000 in 1980-1981. The situation has been rectified.

On the basis of a mechanical projection, and including $400 000 000 in budget cutbacks next year, the budget deficit should reach $2 705 000 000 in 1987-1988, and $2 590 000 000 in 1988-1989. I do not intend to exceed these levels of deficit.

Our fight against the deficit must continue in coming years, and the government intends to follow a gradual approach in this respect. In doing so, it will, little by little, regain the financial flexibility it has lost by living beyond its means for several years, without hindering the economy or unfairly penalizing Quebecers for past mistakes. Were the government to reduce the deficit to about $2 000 000 000 in the coming years, it would be possible to stabilize the portion of total debt in relation to GDP. Thus, the portion of budget revenues which must be allocated to debt servicing would stop growing. We would at last break the vicious circle obliging us to reduce our expenditures in the current year to pay those of preceding years.

Reducing expenditure

Obviously, reducing expenditure is no easy task, nor is it a painless undertaking. Taken individually, all government programs are useful; a number of them are even essential. Nonetheless, according to the most recent data available, government spending exceeds that in Ontario by $4 700 000 000 on a comparable basis, which represents $716 per inhabitant. This is far too much to enable us to achieve a competitive tax burden and a reasonable deficit. Consequently, the painful task of effecting budget cuts must be pursued for some time to come.

An initial phase was completed when my colleague, the Chairman of the Conseil du trésor, tabled the estimates last March. Our goal was to reduce spending in an orderly manner, without penalizing the most underprivileged strata of Québec society. In light of the extent of the remedial action needed, it was necessary to slightly modify some of the services offered to Quebecers.

However, this was only a first phase. To further reduce the deficit, it will not suffice to sustain continuity and display considerable caution in establishing new expenditure programs. It will be necessary to examine the relevance of a number of existing expenditures and take the necessary steps to halt the automatic growth of several others.

Several agencies to be abolished

To achieve this task, the government has established a task force under the direction of the Chairman of the Conseil du trésor, which has been asked to

examine government organization. On the basis of the task force's recommendations, the government has already decided to abolish several agencies.

Additional cutbacks

The task force's recommendations will enable us to undertake the next phase of the expenditure reduction plan with rigour, fairness and clarity. This second phase of cutbacks is aimed at reducing expenditure by $400 000 000 in 1987, resulting in a saving of $75 000 000 in 1986-1987. Under the circumstances, the government's recent wage offers are clearly the maximum permitted by Québec's current financial position.

Consequences of the reduction in federal transfers

At a time when Québec is facing a difficult financial position, it is increasingly beset by the serious problem of levelling off of federal transfers. For the 1986-1987 fiscal year, we anticipate that such transfers will fall, in absolute terms, for the second consecutive year, after increasing by only 0.4% in 1984-1985. This situation can be explained primarily by the drop of equalization payments and deindexation by 2% per year of the federal contribution to health and post-secondary education programs.

Reduction in federal equalization payments

With regard to equalization, the problem of declining payments resulting from the 1982 formula has not been solved, despite additional payments of $110 000 000 to Québec in 1985-1986. Worse still, by refusing to pay Québec a further $66 000 000, the federal government has not kept its promise of ensuring each province receiving equalization payments a minimum of 95% of 1984-1985 entitlements; according to the most recent federal estimates, in 1985-1986 Québec will only receive 92.8% of the preceding year's payment. In 1986-1987, the situation will be even worse, as equalization payments should fall again, by $29 000 000, totalling $277 000 000 less than they did in 1984-1985.

Reduction of federal payments for health and post-secondary education

Bill C-96, currently before the federal Parliament and dealing with the financing of health and post-secondary education programs, would, if it were adopted, result in an $82 000 000 shortfall for Québec in 1986-1987. This represents another step in the direction of federal withdrawal from financing essential services. If we add to this the $66 000 000 in equalization payments Ottawa refuses to pay Québec, our government risks facing a $148 000 000 shortfall which would seriously affect government financing in 1986-1987. As the effects of Bill C-96 will increase from year to year, the situation will not improve in the near future.

In this respect, I invite you to consult the Appendix in the Budget Speech dealing with fiscal arrangements. It indicates that the federal government has already considerably reduced transfers to the provinces since 1982, and the disastrous financial consequences of the new cutbacks it plans to impose at present. Moreover, it outlines a conception of what sound financial relations between both levels of government should entail, based on the search for a veritable consensus, compliance with agreements and the maintenance of principles enshrined in the Constitution.

Since our government was elected, I have made every effort to convince my federal counterpart to keep his promise respecting equalization and not alter fiscal arrangements before they expire April 1, 1987. Unfortunately, he has turned a deaf ear to my requests; I can only oppose his decision to transfer part of the federal deficit to the provinces without the latters' having a say in the matter.

Growth in health and education expenditures

Government spending is increasingly being squeezed in a vice. Health costs are growing rapidly because the population is aging and because of the introduction of new medical technologies, while the federal government is

avoiding its financial responsibilities in this sector. The same applies to post-secondary education, where we must meet new challenges in terms of higher education, continuing education and retraining. Under the circumstances, the government has no choice. It is obliged to resort to taxation to compensate for the shortfall resulting from federal cutbacks.

Surtax on corporations

I am announcing a surtax on taxes paid by corporations, to take effect at midnight tonight. The tax on company profits will be raised from 5.5% to 5.9% for major firms and from 3% to 3.22% for small ones. Employers' contributions to the Health Services Fund will also be increased from 3% to 3.22%. The capital tax will be raised from 0.45% to 0.48%. In 1986-1987, the government will receive $152 000 000 as a result of this measure, after deducting its own contribution to the Health Services Fund as an employer. This amount is similar to the shortfall which is attributable to the federal government.

I promise to reconsider the surtax should Ottawa agree to keep its promises concerning equalization and agree to negotiate fiscal arrangements in good faith. I believe that the federal government should revise its way of dealing with the problem in a spirit of fairness, justice, respecting the Constitution and keeping its word. The Appendix on Fiscal Arrangements outlines an overall approach to this problem. The request I am addressing today to my federal counterpart is to undertake without delay veritable federal-provincial negotiations on the basis of this proposal, or any other one aimed at achieving a similar compromise.

It is with regret that I find myself compelled to increase the tax burden of Québec businesses, but I believe that individuals alone must not bear the burden of the current budget gap. Moreover, in spite of the increase, the tax burden of Québec enterprises will continue to be similar to the burden they would have to bear in Ontario.

Commission des normes du travail

The government will immediately introduce a measure designed to reduce parataxation. First of all, the rate of deductions made by the Commission des normes du travail will be reduced from 0.125% to 0.08%. The current rate enables the agency to accumulate surpluses. A lower deduction rate will enable us to normalize the situation. Surpluses will be paid into the consolidated revenue fund.

CSST

Moreover, the activities and premiums of the Commission de la santé et de la sécurité du travail are a major irritant for many Québec businesses. This year, the government will undertake a thorough review of the agency's revenue and expenditure, to ensure that its activities do not hinder the competitiveness of Québec firms. The extent of possible tax relief to be granted to businesses will depend on the scope of rationalization undertaken.

Reform of accounting and elimination of financial problems

As was noted in the pre-budgetary document on government finances, the financial position we inherited last December included heavy burdens, which we have no choice but to face in the short term. At that time, I indicated that these additional financial problems would represent a $150 000 000 burden for Québec's 1986-1987 financial framework. On the basis of our calculations, we realize the amount is actually $240 000 000. Moreover, for several years the Auditor-General has criticized the manner in which the government accounts for certain transactions and, in several instances, the criticisms cover these problems. I will now explain what we intend to do with regard to both interrelated questions.

The financial problems accumulated by the previous government are of the following kinds: an accumulation of deficits in hospitals; a considerable number of bad debts, especially in the ministère du Revenu; and substantial losses to be assumed with regard to certain government corporations.

Now that we have noted the extent of the damage, we must first establish adequate provisions to eliminate these financial problems and display a minimum of responsibility in terms of government finances. Second, we must also determine whether current accounting policies are entirely appropriate.

— Hospital deficits

For several years, the operating costs of Québec hospitals have been chronically underfinanced. Between April 1, 1982 and March 31, 1986, hospitals have accumulated operating deficits of about $260 000 000. Our first effort at staunching the haemorrhage was taken when 1986-1987 estimates were prepared: the budgetary base of hospitals has been restored to put an end to persistent underfinancing of their operations.

Five-year amortization plan

We must now implement a plan for amortizing accumulated deficits, which the government will assume over a five-year period, at a rate of $75 000 000 per year, starting in 1987-1988. Accounting policies covering the accumulated deficits will be changed and they will be recognized as government accounts payable and recorded as liabilities, with the result that as of 1986-1987, interest on principal of about $26 000 000 will be accounted for in government expenditure.

— Bad debts

The state of government accounts receivable has considerably deteriorated in recent years. The provision for bad debts, established every year in order to estimate the actual value of accounts receivable, represented approximately one-quarter of accounts receivable in 1980; today, it accounts for nearly half. As at March 31, 1986, nearly $700 000 000 of accounts receivable were deemed bad debts, including about $600 000 000 in the ministère du Revenu alone.

The accounting policy adopted by the government in this respect since 1980-1981 has been criticized, quite rightly, by the Auditor-General. Bad debts were only recorded in expenditures when the accounts were actually written off, instead of at the time they were deemed bad. This is an unusual practice which, to our knowledge, is not employed anywhere else. The reason it has been employed becomes clearer when one realizes that, over the past five years, accounts receivable totalling nearly $550 000 000 have been deemed bad, while only $20 000 000 or so have been written off and recorded as bad debts.

This is unacceptable with regard to accounting principles. Moreover, write-offs which should have been entered as expenditures in 1986-1987 would have reached $140 000 000. From now on, we will return to the accounting policy employed prior to 1980-1981. Accounts receivable considered to be bad debts will be written off and will no longer undermine the credibility of the government's financial statements.

— Losses of government corporations to be assumed

Until now, no provisions were entered in previous budgets to cover a number of commitments which are as substantial as they are real. In the case of the Société nationale de l'amiante, only part of the interest was entered in expenditure estimates, and no repayment was provided for of the $195 000 000 capital cost of the acquisition of mining subsidiaries which continue to generate losses. The amortization of $320 000 000 in borrowings which Sidbec had

to assume with regard to the activities of Sidbec-Normines and the closing of Gagnon was not covered by a provision. Unanticipated costs of $32 000 000, including $30 000 000 payable in 1986-1987, must be assumed by the government with regard to the termination of the operations of other government corporations which have become burdens to it.

Moreover, as the Auditor-General has often pointed out, the government's financial statements do not reflect long-term drops in the value of certain of its investments, nor do they take into account the occasionally substantial profits which government corporations have actually achieved and accumulated. Current accounting policies will be modified and government investments in the shares of its corporations, rather than being accounted for at cost, will be accounted for on the basis of their consolidated value. The government's books will be adjusted on this basis as at March 31, 1986.

— Reform of accounting policies

The Québec Auditor-General recently expressed serious reservations concerning a number of accounting policies which, in his view, were not suited to the full, accurate presentation of the government's financial position. These reservations covered a number of the subjects I have just mentioned, and the manner of dealing with commitments regarding retirement plans and unrecorded accounts payable.

In recent months, we have studied the Auditor-General's comments, and have undertaken an examination of overall accounting policies employed, with a view to making the appropriate modifications. This examination has taken into account considerations related to current practices and the recommendations of regulatory bodies with regard to accounting and actuarial practices, bearing in mind the particular field of government accounting.

It must be acknowledged that there are still no generally recognized, uniformly applied standards respecting accounting for financial transactions among various governments in Canada. The gouvernement du Québec intends to take into account the opinion of the Auditor-General, while ensuring that Québec is not put at a disadvantage by a comparison of its financial position with that of the other provinces.

With the modifications made in the Budget Speech, outlined in an Appendix, the Québec government's accounting policies will compare favourably with those employed by other governments in Canada. The government's financial position will be presented more rigorously, according to a much more appropriate approach than the one used in the past.

In addition to the matters I have just discussed, government expenditure will, from now on, be accounted for on a veritable accrual basis. Recording will no longer be limited by the availability of appropriations approved by the National Assembly, but will, instead, be centred on expenditures actually made by the government. Accounts payable not recorded as at March 31, 1986 will be charged to liabilities, and all accounts payable will be recorded therein in coming years. Legislation will soon be tabled in the National Assembly to make official this manner of entering and regularizing appropriations which will be needed to amortize accounts payable as at March 31, 1986. Changes made will cover, in particular, deficits accumulated in the health and education networks I have just mentioned.

With regard to commitments related to public sector retirement plans, these problems go beyond the simple accounting policies applied to them. Discrepancies are numerous and often substantial between the methods used by various governments in Canada to assess and account for them. The results obtained are highly sensitive to the use of hypotheses or varying methods of calculation. Following the preliminary examination which has just been effected, it appears that the gouvernement du Québec is currently more rigorous in this respect than other governments.

Task force on retirement plan commitments

A task force will be established to study the entire question. It will call upon accountants and actuaries to examine our overall methods of evaluating and accounting for commitments respecting retirement plans and compare them to those employed by other governments. Until the task force publishes its conclusions, current accounting policies will be maintained.

Accounting for currency fluctuations

From now on, foreign borrowings will be accounted for according to recent policies. Instead of being recorded at the exchange rates prevailing when borrowings were made, debt in foreign currencies will be reevaluated according to the exchange rates in effect at the end of each fiscal year; the discrepancy attributable to fluctuations in exchange rates over the year will be amortized over the remaining life of the borrowings. The discrepancy accumulated in this respect as at March 31, 1986 will be recorded in the government's books through an equivalent correction to the public debt and net debt.

While the changes in accounting policies I have just outlined do not in any way alter the government's net financial requirements, they will, in particular, offset the effect of the cost of amortizing debts on budgetary transactions.

Increased recourse to fees

Fees are underutilized as a source of revenue in Québec. This applies equally to services provided by the government and those offered by the health and education networks which the government subsidizes.

Where possible, fees have the double advantage of discouraging abusive use of services and being among the rare sources of revenue which do not hinder economic output. It is obvious that, if Québec wishes to continue to maintain a high level of public services, increased recourse to at least partial fees charged on such services must be much more seriously contemplated. This is one way of recognizing that government services are never free: where the beneficiary pays nothing, it is because someone else does it for him.

In the fields of health and education, on the basis of observations in the document published last March on the state of government finances, we must find the means of complying with the principles of universality and accessibility, and place greater emphasis on fees to ensure more equitable, efficient financing. As these services are partially financed by the federal government, it is obvious that our discussions with Ottawa on its financial contribution to programs will affect the decisions we make.

With regard to the recovery of $24 000 000 already announced concerning dental services for children, $8 000 000 will come from the elimination of insurance for certain services. As for the balance, it will be funded directly from the proceeds of the tax measures announced in this budget.

Fees

On the other hand, I intend to raise the fees on government services by $75 000 000. Fee increases will cover specific services and users will assume a greater portion of costs. The previous government anticipated moving in this direction.

We will adopt a new procedure for budgeting fees. The objective of $75 000 000 will be broken down into departmental fee objectives, which will be approved by the Cabinet. Greater effort will be demanded on the part of departments in which self-financing is more limited. Each department will be responsible for achieving the objective adopted. The operation will be carried out fairly and efficiently. Of course, these increased fees will make it possible to avoid raising taxes by the same amount.

Following discussions with the Régie de l'assurance automobile, the latter has agreed to pay the government $40 000 000 to reimburse medical services received by insured parties in previous years.

Tax expenditures

In the pre-budgetary document published last March, I also broached the question of tax expenditures, i.e., tax exemptions, deductions or credits which result in a reduction in government revenues. At the time, I noted that the overall tax base has eroded during the past decade.

I believe it is time for the government to start putting this domain in order, bearing in mind that our initiatives are singularly limited by what the federal or other provincial governments do. For this reason, we will proceed gradually, trying at every step of the way to convince our Canadian partners of the validity of our position and the relevance of our initiatives.

Interest and dividend income deduction and retirement income deduction

However, I do intend to act immediately with respect to two tax deductions which do not have the same justification now they did before. Therefore, I am announcing, as of the 1986 taxation year, a $500 reduction in the $1 000 interest and dividend income deduction and the pension income deduction.

The elderly to be protected

However, I wish to reassure the elderly: they will not be penalized by this measure if they are retired and receive no employment income, and will continue to be entitled to the same deduction as they currently are.

I would like to point out that both deductions were implemented in the mid-1970s to protect taxpayers from taxation of interest income artificially increased by inflation, and erosion of retirement income resulting from increases in prices. Inflation has considerably abated in recent years, thereby reducing the justification for the deductions.

Availability allowance

An availability allowance for children under 6 was introduced in 1981; at that time, Québec did not offer exemptions for such children. Moreover, the taxation system made no distinction between children under or over 6 with respect to deductible child care expenses.

The situation has changed considerably since the reform of the personal tax system came into force last January 1. There is currently a $1 870 exemption for the first dependent child, and a $1 370 exemption for subsequent children. The justification for an availability allowance may well be questioned, at least in its current form. For this reason, it must be reexamined in relation to decisions the government will make in the coming months on policies concerning the family.

Local governments

I know that some municipalities are facing special taxation problems which it is important to settle as quickly as possible. Relations between the government and the municipalities lead me to believe that cooperation is the only suitable

approach. It should also be acknowledged that local governments are often the best suited to fulfil certain needs among taxpayers and provide a number of services. The gouvernement du Québec must ensure that local governments assume their role entirely and have appropriate sources of financing.

Nonetheless, its strikes me as important to wait for the publication of recommendations made by various task forces responsible for examing the situation of municipalities, the powers of municipalities and RCMs, and those of the Commission d'étude sur la Ville de Québec. Only then will the government be able to react to these recommendations, elaborate suitable proposals and make known its policies respecting financial relations with local governments.

Other measures

— Fuel and cigarettes

I would now like to turn to a subject which has been widely discussed in recent years and, in particular, in recent months, i.e., fuel and cigarette taxes.

As you are well aware, both types of products are currently taxed on the basis of a so-called "escalator tax", contingent on the retail price of the goods and set on the basis of surveys carried out by the ministère du Revenu.

The price of oil increased appreciably between 1980 and 1985. During this period, the tax increased from 20% to 40% in November 1981, then was reduced to 30% two years later. In recent years, it has fluctuated considerably.

Transformation of the escalator tax into a specific tax

We have decided to halt the escalator once and for all. As of midnight tonight, taxes on fuel will be set by law at current levels. When the government wishes to raise or lower them, it will proceed as it did prior to 1980. Consumers will benefit from any drop attributable to market conditions and will not be more heavily taxed simply because oil prices have risen again.

Furthermore, last December, we abolished the surtax on fuel in Québec's outlying regions: Abitibi-Témiscamingue, Côte-Nord, Gaspésie, Nouveau-Québec and Saguenay—Lac Saint-Jean. Motorists in these regions will, of course, continue to benefit from this measure.

Fuel tax reduction in new designated zones

I believe, however, that other regions find themselves in a similar situation. I intend to grant them, as of tonight, the same reduction in fuel tax, i.e., 4.8 cents per litre on regular unleaded gasoline. First, this means expanding the Gaspésie zone to include the western part of Matapédia riding. Second, the northern region of the Laviolette and Gatineau ridings will be added.

In addition, two new regions will be designated: Rimouski riding and the part of Labelle riding west of the rivière du Lièvre, including the town of Mont-Laurier. In both regions, the tax will be reduced by 2.4 cents per litre.

Finally, I would like to touch upon the question of the support given to retailers along the U.S. border. Presently, only a few retailers located within three kilometres of the American border benefit from a tax reduction program in order for them to be able to compete with gas stations across the border. Yet Québec gas retailers located within 20 kilometres of the border with another Canadian province can benefit from a fuel tax reduction program.

I believe that it is unfair to treat retailers differently depending on whether they are located near the U.S. border or a border with another Canadian province. That is why I have decided to implement a fuel tax reduction for retailers located within 20 kilometres of a contact point with the United States. In the case

of a retailer located less than five kilometres from the border, the reduction is equal to a third of the tax, i.e., 4.8 cents a litre for regular unleaded gasoline; the reduction will decrease up to a distance of 20 kilometres from the border.

The border zone extends along the Kamouraska-Témiscouata, Montmagny-L'Islet, Bellechasse, Beauce-Sud, Mégantic-Compton, Orford, Brome-Missisquoi, Saint-Jean-Iberville and Huntingdon ridings.

Tobacco

Smokers and tobacco industry workers will not take us to task for withdrawing the escalator tax on cigarettes. Over the past year, repeated increases in the price of cigarettes imposed by manufacturers or the federal and provincial governments have been a considerable burden to this category of taxpayers. In my opinion, it would be unfair to maintain the current taxing mechanism. I am, therefore, announcing that as of midnight tonight the tax on cigarettes and processed tobacco will once again become specific, as is the case with the fuel tax. From now on, the tax will no longer vary according to changes in the price of cigarettes. Smokers must be allowed to catch their breath.

— Taxation of various types of energy

An unfair situation currently exists with respect to the taxation of various types of energy in Québec. Only electricity and propane gas users pay the 9% Québec sales tax; consumers of heating oil and natural gas are wholly exempted from it. In the case of natural gas, the exemption dates from 1983 and was granted to foster the penetration of this type of fuel in Québec.

It is obvious that such a situation is unfair to electricity and propane gas users in relation to consumers of heating oil and natural gas.

Heating oil and natural gas

The government has, therefore, decided to rectify this situation. As of midnight tonight, the sales tax exemption enjoyed by heating oil and natural gas is being eliminated. However, as is the case with respect to electricity, the tax exemption is being maintained on both fuels when used for production. This means that all categories of enterprises in Québec will pay no tax on the energy they use in their production process, regardless of what type of energy they use. This measure will bring the government $97 000 000 in revenue in 1986-1987.

Low-income earners to be protected

The drop in the price of heating oil and natural gas resulting from the recent fall in oil prices will help attenuate this fiscal measure's impact on consumers. Moreover, we will introduce measures to obviate the effect of the tax on social aid beneficiaries, low-income wage earners and those 60 or over. When social aid scales are reviewed again in January 1987, account will be taken of an annual amount of $15 per adult and $6 per child. Similarly, the consumer tax credit for low-income earners and the real estate tax credit for the elderly will be raised by the same amounts.

— Measures to assist the regions

Québec is an exceedingly vast territory and it would be wrong to think that it is possible to apply uniform policies therein without taking into account the special needs of various regions, which often face higher transportation and travel costs. It is also apparent that regional economic development usually rests on less solid foundations and that the economic situation can seriously deteriorate. In addition to granting the fuel tax reductions announced tonight and last December, I intend to propose in this budget a certain number of measures to favour the regions.

Fisheries

The first is intended to encourage the fishing industry by reducing taxes applicable to it. As of midnight tonight, a tax exemption on the first $300 000 of paid-up capital will be granted to corporations whose principal activity is fishing. However, a minimum tax of $50 will apply. Thanks to this measure, the fishing industry will, from now on, benefit from the same tax treatment as the farming industry, in terms of capital tax.

$10 000 000 additional allocation for municipal road works

Second, it seems necessary to me to improve the road network in several Québec regions. For this reason, I am announcing an increase of $10 000 000 in appropriations for the improvement of municipal roads in 1986-1987; they will rise from $12 000 000 to $22 000 000.

Promotion of tourism

Third, it is well known that the tourist industry is a major source of employment in several regions of Québec. This year, we can expect American tourists to flock to the Canadian border. We must find a way to draw them to Québec. An additional $1 000 000 will be allocated to encourage Americans to visit Québec.

$10 000 000 additional allocation for the Regional Development Fund

Moreover, I intend to substantially increase support the government provides for regional economic development. I do not believe that it can be said that the regions lack initiative in ensuring their economic growth. To the contrary, numerous projects have been undertaken and residents have shown a remarkable willingness to take charge of their affairs. Québec's immense territory must be a vital living space, rather than a simple reservoir of natural resources. To enable the regions to better sustain their economic development initiatives, I am announcing an increase of $10 000 000 in appropriations allocated in 1986-1987 to the Regional Development Fund. This is an increase of nearly 100% in relation to the $12 000 000 initially anticipated.

$23 000 000 for wage earners in the far North and designated isolated posts

To conclude, we must also help wage earners in Québec's far North, and those in designated isolated posts, to the extent that they must bear higher subsistence costs. I am announcing that Québec will implement measures identical to those which the federal government has just adopted. A deduction of $225 per month will be granted to every wage earner working in these areas. The deduction will total $450 per month per dwelling for those living in independent dwellings. This new measure is more advantageous than the tax exemption which used to be granted to them and represents a $23 000 000 annual cost. However, it will only be applied in the 1987 tax year and will not affect the 1986-1987 financial framework. Taxpayers in the counties of Ungava and Duplessis and those in designated isolated posts in Québec are likely to benefit from this measure.

Students in outlying regions

Our government is also sensitive to problems encountered by students from outlying regions, whose parents must assume considerable transportation and subsistence costs to enable them to complete post-secondary studies. We are currently examining a number of measures designed to improve the situation.

Financial framework

I would now like to examine the overall impact on the financial framework of the various measures I have just announced. First of all, let us take a look at the current fiscal year.

STATEMENT OF FINANCIAL TRANSACTIONS, 1986-1987
(in millions of dollars)

1. Budgetary transactions		
Revenue	+25 585	
Expenditure	−28 480	
Deficit		−2 895
2. Non-budgetary transactions		
Investments, loans and advances	+ 150	
Retirement plans account	+ 1 365	
Other accounts	− 300	
Surplus		+1 215
3. Net financial requirements		−1 680
4. Financing		
Change in cash position	+ 80	
New borrowings	+ 2 850	
Repayments of borrowings	− 1 250	
Total		+1 680

Late last March, the Chairman of the Conseil du trésor tabled estimates of $28 750 000 000 and probable expenditure totalling $28 575 000 000 for 1986-1987. Our tight controls over day-to-day management of expenditures have already resulted in anticipated lapsed appropriations of $175 000 000. New budget cutbacks I mentioned earlier will be implemented this fall and will lead to an additional $75 000 000 reduction in expenditure in 1986-1987. Moreover, other measures in this Speech, including changes in accounting policies and the recent reassessment of a number of economic parameters have resulted in a $20 000 000 reduction in probable expenditure for 1986-1987.

Budgetary expenditure for the 1986-1987 fiscal year should total $28 480 000 000, a 4.6% increase in relation to the previous year. This is 1.3 percentage points below what is forecast for economic growth.

Revenue in 1986-1987 is expected to total $25 585 000 000, a 6.3% increase over 1985-1986. In light of falling federal government transfers, we have had to impose an additional burden on Québec taxpayers in order to balance our accounts. The rate of growth of own-source revenue, including the effects of fiscal measures in this budget, is 8.5%.

The anticipated budget deficit for the 1986-1987 fiscal year is $2 895 000 000, which is $257 000 000 lower than last year. For the first time since 1973-1974, Québec's budget deficit has dropped for the second consecutive year.

The non-budgetary transaction surplus is expected to reach $1 215 000 000, a $240 000 000 drop compared with the preceding fiscal year. Essentially, this is the result of the anticipated elimination of accounts payable recorded at the end of 1985-1986 to reflect government wage offers to public sector employees and accounts which will be charged to government liabilities following changes in accounting policies.

As a result, the government's net financial requirements in 1986-1987 will total $1 680 000 000. The cash position, currently $560 000 000, will be reduced by $80 000 000 at the end of the fiscal year. Taking into account $1 250 000 000 in anticipated repayments of current debt, this will enable the government to limit to $2 850 000 000 new borrowings in 1986-1987, i.e., $142 600 000 less than in 1985-1986.

As a result, the government's net financial requirements in 1986-1987 will total $1 680 000 000. The cash position, currently $560 000 000 will be reduced by $80 000 000 at the end of the fiscal year. Taking into account $1 250 000 000 in anticipated repayments of current debt, this will enable the government to limit to $2 850 000 000 new borrowings in 1986-1987, i.e., $142 600 000 less than in 1985-1986.

The financial framework for 1986-1987 shows that the gouvernement du Québec has definitely begun to implement recovery measures. As I indicated earlier, several other steps will have to be taken to achieve complete recovery. The measures I have just announced will lead to a $2 705 000 000 deficit in 1987-1988 and a $2 590 000 000 deficit in 1988-1989. The Appendix on the medium-term outlook of the financial position gives further details about these estimates and their meaning. However, the projection shows that action planned up until now will not result in more substantial reductions in the deficit.

The fact remains that, when the time comes, such a course will have to be followed. As I indicated in the pre-budgetary document on the state of public finances, excessive growth of debt service will have to be controlled and brought back to a rate which does not exceed that of our ability to pay. As demonstrated in the Appendix on the medium-term outlook, this would be possible with a deficit of the order of $2 000 000 000. The extent of this challenge is clear. However, I feel that the success of the recovery measures applied to date is convincing evidence that reaching such an objective is possible.

Conclusion

The basic orientation of this first real budget of our administration is to restore public finances without endangering economic growth and job creation.

The challenge was formidable since a differential of $1 500 000 000 had to be made up in order to bring the budget deficit back to an acceptable level. The deficit will be reduced below $2 900 000 000, i.e., $257 000 000 less than that of the fiscal year that has just ended. We will succeed, in spite of the regrettable attitude of the federal government concerning equalization and other transfers related to the fiscal arrangements. Furthermore, for the first time in 10 years, we have balanced the current account, and everything indicates that this balance will continue to improve in coming years.

At the same time, we have reformed the government's accounting policies. As a result, public accounts will better reflect our financial situation. We have begun to solve the financial problems accumulated by the previous government. We have improved several aspects of Québec's tax system. Through an operation which must be credited to my Cabinet colleagues, we have begun to establish some order in the government's expenditures by means of cuts and reductions totalling about $1 000 000 000. To have achieved this while providing fair public sector wage increases instead of cutting wages is not the least of this operation's achievements. The time when we could have our descendants pay for current expenditures has ended.

I would also like to insist on the fact that, while the government has been very concerned by financial matters in recent months, we have not forgotten Quebecers' essential needs. For this reason, we have, for example, allocated considerable funds to solve the problem of hospital emergency room crowding and restore financial health in Québec hospitals. Public health is sacred.

I sincerely believe that these concrete results will strengthen the confidence the people of Québec have in its future. Of course, a number of Quebecers would have liked us to go further and faster in applying relief for the taxpayer. I am thinking in particular of the tax on insurance premiums which we were able to only partially abolish when we took power because the financial position was much more precarious than what the previous government had described in its budgetary documents. Should the economic situation continue to improve between now and the end of the year, a new phase could be accomplished. Others would have wanted us to immediately allocate additional appropriations to answer needs we consider as valid today as we did a few months ago. But we had to start at the beginning, that is, put the house in order before undertaking other steps to ensure to the economic and social development of Québec.

We still have a long way to go before the immense potential of our economy is developed. But, strengthened by the progress we have achieved in such a short time to improve public finances, I am convinced that we are on the right track.

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
BUDGETARY REVENUE
1986-1987 FORECAST
(in millions of dollars)

1. Income and property taxes	
Personal income tax	8 108
Employer contributions to Health Services Fund	1 813
Corporate taxes[1]	1 191
	11 112
2. Consumption taxes	
Retail sales	3 605
Fuel	1 114
Tobacco	606
Meals and hotel	354
Other[2]	139
	5 818
3. Duties and permits	
Motor vehicles	320
Alcoholic beverages	72
Natural resources[3]	96
Pari-mutuel	26
Other	95
	609
4. Miscellaneous revenue	
Sales of goods and services	277
Interest	219
Fines, confiscations and recoveries	217
	713
5. Revenue from government corporations	
Société des alcools du Québec	400
Loto-Québec	350
Hydro-Québec	133
Other	140
	1 023
Total own-source revenue	**19 275**
6. Government of Canada transfers	
Equalization	2 825
Other transfers pertaining to fiscal arrangements	1 911
Contributions to welfare programs	1 213
Other programs	361
Total Government of Canada transfers	**6 310**
Total budgetary revenue	**25 585**

1 Includes taxes on corporate profits, capital and insurance premiums.

2 Includes tax on telecommunications and on electronic advertising.

3 Includes forest, mining and water resources.

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
BUDGETARY EXPENDITURE
1986-1987 FORECAST
(in millions of dollars)

Budgetary expenditure by department or agency	
Affaires culturelles	192.9
Affaires municipales	746.1
Agriculture, Pêcheries et Alimentation	507.0
Assemblée nationale	60.0
Commerce extérieur et Développement technologique	23.5
Communautés culturelles et Immigration	28.9
Communications	226.1
Conseil exécutif	35.3
Conseil du trésor	19.7
Éducation	4 587.6
Énergie et Ressources	384.4
Enseignement supérieur et Science	2 473.1
Environnement	249.3
Finances	3 501.8
Industrie et Commerce	293.3
Justice	363.6
Loisir, Chasse et Pêche	195.1
Main-d'oeuvre et Sécurité du revenu	3 048.8
Office de planification et de développement du Québec	45.9
Organisme relevant du ministre délégué à l'Administration	945.1
Organismes relevant de la ministre déléguée à la Condition féminine	85.1
Organismes relevant de la Vice-présidente du Conseil exécutif	182.9
Organismes relevant du ministre délégué aux Services et Approvisionnements	21.5
Personnes désignées par l'Assemblée nationale	24.2
Régie de l'assurance-maladie du Québec	1 685.9
Relations internationales	48.7
Revenu	258.3
Santé et Services sociaux	6 280.6
Solliciteur général	478.9
Tourisme	69.7
Transports	1 630.0
Travail	56.7
Total	**28 750.0**
Plus: ☐ Additional expenditure[1]	**116.0**
Less: ☐ Anticipated lapsed appropriations	**175.0**
☐ Additional cutbacks	**75.0**
☐ Effects of changes in accounting policies	**136.0**
Total probable expenditure	**28 480.0**

1 ☐ Regional Development Fund	10.0
☐ Municipal road works	10.0
☐ Increase in expenditure following reassessment of a number of economic parameters and cutbacks	31.0
☐ Expenditure related to accumulated financial problems	30.0
☐ Tourist advertising	1.0
☐ Young farmers	7.0
☐ Contributions to the Health Services Fund	25.0
☐ Transfers related to the increase in the sales tax credit	2.0
	116.0

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
NON-BUDGETARY TRANSACTIONS
1986-1987 FORECAST
(In millions of dollars)

1. Investments, loans and advances		
Enterprises of the gouvernement du Québec		
Share capital and invested capital:		
Société de récupération, d'exploitation et de développement forestiers du Québec (REXFOR)	– 27.0	
Société générale de financement du Québec (SGF)	– 30.5	
Société nationale de l'amiante (SNA)	– 23.5	
Société québécoise d'exploration minière (SOQUEM)	–	
Société québécoise d'initiatives agro-alimentaires (SOQUIA)	–	
Société québécoise d'initiatives pétrolières (SOQUIP)	– 5.0	
Other	+ 111.5	
		+ 25.5
Loans and advances:		
Société immobilière du Québec (SIQ)	+ 150.0	
Other	– 14.9	
		+ 135.1
Total enterprises of the gouvernement du Québec		+ 160.6
Individuals, corporations and other		– 10.6
Total investments, loans and advances		+ 150.0
2. Retirement plans account		
Employer and employee contributions	+1 890.0	
Benefits and other payments	– 525.0	
Total retirement plans account		+1 365.0
3. Other accounts		– 300.0
Non-budgetary transaction surplus		**+1 215.0**

N.B.: A (–) sign indicates a financial requirement and a (+) sign, a source of financing.

APPENDIX A

Fiscal and Budgetary Measures

Improvement in taxation in regard to employees and new corporations 5

Special deduction in regard to shares purchased by employees 5
— *The Québec Stock Savings Plan (QSSP)* 5
— *Sociétés de placements dans l'entreprise québécoise (SPEQs)* 5

Exemption for new corporations 6

Start-up assistance for young farmers 7

Measures concerning revenue 7

Surtax on business firms 7
— *Employer contributions to the Health Services Fund* 7
— *Tax on capital* 7
— *Corporate income tax* 8

Standardization of taxation of various types of energy 9
— *Elimination of certain exemptions* 9
— *Compensation measures for low-income taxpayers* 9
— *Adjustment for aircraft fuel and locomotive fuel oil* 10

Restrictions on the interest and dividend deduction and on the retirement income deduction 10

Measures concerning outlying regions 11

Reduction in the fuel tax 11
— *Extension of peripheral regions* 11
— *Increased assistance to retailers in border regions and regions bordering on designated regions* 12
— *Special credit for the taxi industry* 13

Reduction in the tax on capital 14
— *Corporations in the fishery sector* 14
— *Associated corporations eligible for the $300 000 deduction* . 14

Special deduction for residents of the Far North and of designated isolated posts 14

Improvements in the municipal road network 15

Regional Development Fund 15

Tax adjustments related to the capitalization of business firms 15

The Québec Stock Savings Plan (QSSP) 15
— Conditions related to share issues 15
— Value of property held by an eligible corporation 16
— Rule for the last taxation year 16
— Employees of the eligible corporation 17
— Shares acquired by exercising a warrant 17
— Eligible shares purchased or redeemed by the issuing corporation 18
— Investment corporations 18
— Advance rulings 19
— Penalties 19
— Technical modifications 20

Sociétés de placements dans l'entreprise québécoise (SPEQs) 20
— Extension of the criterion of wages paid in Québec 20
— Maintenance of the minimum paid-up capital of a SPEQ 21
— Tightening the rules governing non-arm's-length dealing 21
— Supplementary conditions on eligible investments 22
— Limit on amounts deductible 22
— Utilization of funds received from a SPEQ 22
— Technical modifications 23

The Cooperative Investment Plan (CIP) 24

Restriction to the Loans for Capitalization Program (LCP) . 24

Elimination of part of the Financial Assistance Program for the Capitalization of Corporations 25

Miscellaneous measures 26

Conversion of "ad valorem" taxes into specific taxes 26
— Fuel tax 26
— Tobacco tax 26

Refund of the fuel tax to Indians 26

Sales tax on insurance premiums 26
— Exemption for aircraft insurance premiums 26
— Taxation of reciprocal insurance 27
— Introduction of a tax-free threshold 27

Taxation of income from an eligible business firm 27
— Savings and credit unions 27
— Service and management corporations 27

Technical modification concerning the taxation of government corporations 28

Tourism advertising 28

Concordance with federal legislation and regulations 28

Tax treatment of dividends 28

$500 000 lifetime capital gains exemption 29

Measures in the 1986-1987 federal Budget Speech and other measures 29

Summary of the financial impact of fiscal measures 31

Improvement in taxation in regard to employees and new corporations

Special deduction in regard to shares purchased by employees

To improve cooperation between employees and employers in developing their business, its efficiency, its productivity and its profitability, an additional deduction over and above those already existing for the purposes of the Québec Stock Savings Plan and the Sociétés de placements dans l'entreprise québécoise is introduced and will apply to shares purchased after the Budget Speech.

— The Québec Stock Savings Plan (QSSP)

QSSP: additional tax benefit of 25 percentage points for employees and management

From now on, corporations whose shares are eligible for a deduction for the purposes of the Québec Stock Savings Plan may set up a stock ownership plan to enable the corporation's employees and management to enjoy an additional tax benefit of 25 percentage points. To entitle the participant to the additional deduction, such plans must satisfy the following conditions:

- ☐ be managed by a trustee empowered to reach an agreement with an individual for the purposes of the QSSP, and accredited by the ministère du Revenu;
- ☐ be open only, and without exception, to the corporation's employees and management holding less than 5% of the shares of the corporation's capital stock; and
- ☐ provide means for financing the purchase of the corporation's shares, such as loans, with or without interest, repayable over a fixed period, through salary withholdings.

The trustee, as manager of the stock ownership plan, must have custody of the shares for the purposes of the Québec Stock Savings Plan, so that at the end of the year, he may issue statements certifying the purchase of shares eligible for inclusion in the QSSP.

This additional deduction does not, in any way, change the Québec Stock Savings Plan's rules of operation. Therefore, the other rates of deduction, and the ceilings, remain unchanged.

— Sociétés de placements dans l'entreprise québécoise (SPEQs)

SPEQ: additional tax benefit of 25 percentage points for employees and management

From now on, eligible corporations for the purposes of an investment by a SPEQ may set up a stock ownership plan to enable the corporation's employees and management to enjoy an additional tax benefit of 25 percentage points when they purchase shares of their company through a SPEQ. To entitle participants to the additional deduction, such plans must satisfy the following conditions:

- ☐ be managed by a trustee empowered to reach an agreement with an individual for the purposes of the QSSP, and accredited by the Société de développement industriel du Québec (SDI);
- ☐ be open only, and without exception, to the corporation's employees and management holding less than 5% of the shares of the corporation's capital stock; and

- provide means for financing the purchase of shares in the capital stock of the "Employee-SPEQ", including a loan, with or without interest, repayable over a fixed period, through salary withholdings.

The trustee, as manager of the stock ownership plan, must have custody of the shares to protect the employer, if need be, up to the full amount of the loan granted to the employee under the stock ownership plan.

For the purposes of this plan, an "Employee-SPEQ", to be registered as such with the SDI, must satisfy the following conditions:

- each employee or manager of the corporation in which the SPEQ makes an eligible investment may acquire common shares of the "Employee-SPEQ" with full voting rights; and

- all of its share capital must be held by the corporation's employees and management.

More specifically, all rules governing SPEQs will apply, with adaptations, to "Employee-SPEQs".

Exemption for new corporations

To facilitate the formation of new firms, an exemption will be granted in regard to income tax and the tax on capital to corporations incorporated after the day of the Budget Speech.

Exemption from income tax and the tax on capital applicable for three years

This tax exemption will apply to the first three taxation years of new corporations, and only to income which would otherwise be taxable at a rate of 3% if the surtax introduced in this Budget Speech did not apply. It will also apply to the portion of the tax on capital attributable to the first $2 000 000 in paid-up capital which would otherwise be payable by such a corporation for each of these first three years but, in no case, shall this tax be less than $100 per year.

To be eligible for this three-year tax exemption, the corporation must have carried on an eligible business during the year within the meaning of paragraph *e* of section 451 of the Taxation Act. In addition, to benefit from this exemption, a corporation must obtain confirmation of its eligibility from the ministère du Revenu.

In addition, to ensure that only new firms benefit from this measure, and to prevent firms from incorporating solely for the purpose of benefiting from the new tax exemption, a corporation will not be eligible for this exemption if it, or a corporation it may have replaced as a result of a merger, at any time since their incorporation:

1. was affiliated with any other corporation;
2. carried on a business other than an eligible business;
3. carried on an eligible business as a member of a partnership;
4. was the beneficiary of a trust;
5. carried on an eligible business as a co-participant in a joint venture with another corporation; or
6. carried on an eligible business as a result of acquiring or renting property:

- from another corporation in regard to which it, one of its shareholders, or any person affiliated with it or with one of its shareholders, owned, at any time, more than 10% of the shares of any class of the capital stock of the corporation from which the property was acquired or rented; or

- from another person with whom it is affiliated, or with whom it was affiliated in the 12 months preceding its incorporation, and if this other person operated a business and used the property in operating such a business.

To ensure the fiscal integrity of this measure, the Minister of Revenue may refuse to grant this exemption.

Measures will also be introduced to limit the application of the rules governing loss carry-overs for corporations enjoying this exemption and the credit for losses will also be changed accordingly.

Finally, a corporation which has benefited from the tax exemption during a period must pay tax installments in the year immediately following this period, calculated as if it had not benefited from the exemption during such period.

Start-up assistance for young farmers

Appropriations for the Development of Farming Operations Program will be increased by $7 000 000. For fiscal 1986-1987, they will rise from $5 000 000 to $12 000 000.

Measures concerning revenue

Surtax on business firms

Due to the federal government's decision to have the provinces support a portion of its efforts to reduce its deficit on the one hand, and in order to avoid having such an orientation lead to a deterioration in the quality of health and post-secondary education services on the other, the Québec government has chosen to levy a compensatory surtax. Beginning at midnight on the evening of the Budget Speech, a 7.25% surtax will apply to the employer contributions to the Health Services Fund, to the tax on capital and to corporate income tax.

— Employer contributions to the Health Services Fund

This surtax will apply to employer contributions on wages paid or deemed paid after the day of the Budget Speech. All employers who pay this contribution must pay this surtax.

— Tax on capital

This surtax will apply to the tax on capital payable for taxation years ending after the day of the Budget Speech. For a taxation year overlapping the day of the Budget Speech, the surtax will apply proportionally to the number of days of the taxation year following the day of the Budget Speech.

Furthermore, beginning in May, installments on the tax on capital must be calculated taking this surtax into consideration. Thus, beginning with the May installment, corporations must pay the government an installment that is increased by the amount of this surtax.

Nevertheless, the surtax will not apply to the tax on capital of insurance corporations or to the special 1 % tax on the capital of oil refining corporations.

Finally, the surtax will be taken into account in calculating the limit of the refundable tax credit for losses; currently, this credit equals three times the amount of the tax on capital. Thus, the limit on the amount a corporation will be able to claim as a refundable tax credit for losses suffered during a taxation year ending after the day of the Budget Speech will be three times the tax on capital, including the surtax.

— Corporate income tax

This surtax will apply to the income tax payable for taxation years ending after the day of the Budget Speech. For a taxation year that overlaps the day of the Budget Speech, the surtax will apply proportionally to the number of days of the taxation year following the day of the Budget Speech.

Moreover, beginning in May, income tax installments must be calculated taking this surtax into consideration. Thus, beginning with the May installment, corporations must pay their installment plus the amount of this surtax.

EFFECTIVE RATES FOR EMPLOYER CONTRIBUTIONS TO THE HEALTH SERVICES FUND, FOR THE TAX ON CAPITAL AND FOR INCOME TAX (Rounded)

	Before Budget Speech	After Budget Speech
	%	%
Employer contributions to the Health Services Fund	3.00	3.22
Tax on capital		
☐ Banks, loans and trust corporations	0.90	0.97
☐ Other corporations	0.45	0.48
Corporate income tax		
☐ Active business income		
— eligible for SBD[1]	3.00	3.22
— other income	5.50	5.90
☐ Income from non-active business	13.00	13.94

1 Federal small business deduction

All of these changes will generate additional revenue of $170 000 000 for the government for a full taxation year, of which $118 000 000 from private sector business firms as shown in the following table.

FINANCIAL IMPACT OF THE SURTAX FOR A FULL TAXATION YEAR (in millions of dollars)

	Direct impact of the surtax				
	Employer contributions to HSF	Tax on capital	Income tax	Indirect impact on income tax	Impact on the tax burden
Private sector					
Corporations and cooperatives	74	32	35	(25)	116
Unincorporated firms	5			(3)	2
Subtotal	**79**	**32**	**35**	**(28)**	**118**
Public sector					
Government of Canada	4				4
Government of Québec	27				27
Municipalities and their agencies	4				4
Federal Crown corporations	4	n.a.	n.a.		4
Québec government corporations	3	10			13
Subtotal	**42**	**10**			**52**
TOTAL	**121**	**42**	**35**	**(28)**	**170**

n.a.: not available

These changes will have a positive impact on the government's financial balance of $152 000 000 for the 1986-1987 fiscal year.

Standardization of taxation of various types of energy

— *Elimination of certain exemptions*

Currently, the taxation of type of energy differs depending on the type of energy utilized. Whereas the retail sales tax of 9% applies to purchases of electricity and propane, it does not apply to purchases of natural gas, heating oil, kerosene or coal.

9% sales tax on purchases of natural gas, heating oil, kerosene and coal

In order to standardize the taxation of various types of energy, the retail sales tax will also apply to purchases, made after midnight of the evening of the Budget Speech, of natural gas, heating oil, gasoline, kerosene and coal used for purposes other than powering a driving engine as defined in the Fuel Tax Act. However, fuel used for the purposes of powering an engine will continue to be exempted from the retail sales tax.

In regard to payments for natural gas covering a consumption period overlapping the day of the Budget Speech, the tax will be payable proportionally to the number of days of the period following the day of this Speech.

Furthermore, the current exemption concerning electricity and gas used in the production of moveables intended for sale will be extended to include these forms of energy.

This measure represents additional revenues of $97 000 000 for 1986-1987.

— *Compensation measures for low-income taxpayers*

So as to avoid penalizing low-income households as a result of standardizing the taxation of forms of energy, compensation measures will come into effect as of January 1, 1987, as reimbursement of the sales tax on forms of energy used, among other things, for heating.

For low-income earners, the consumption tax credit introduced in 1986 to take into account taxes on essential needs will be increased for the 1987 taxation year by $15 per spouse and $6 per dependent child. Therefore, the amounts of the credit for 1987, $69 per spouse and $23 per child, will rise to $84 and $29 respectively. Moreover, there is also reason to change the amounts scheduled for 1988, currently set at $72 per spouse and $24 per dependent child. For the 1988 taxation year, the consumption tax credit will thus be increased to $87 per spouse and $30 per dependent child.

For social aid recipients, compensation will begin to apply in January 1987. Therefore, in determining the level of social aid scales for 1987, not only will the annual indexation factor and other government assistance measures affecting social aid recipients' income be taken into account but also the compensation amounts of $15 per adult and $6 per dependent child.

For low-income persons aged 60 or over, the compensation measure that will apply beginning in the 1987 taxation year consists of increasing the additional amount of $85 included in the property tax refund by $15 per spouse currently eligible. In this way, beginning in the 1987 taxation year, low-income persons aged 60 or over will benefit from an amount of $100 per eligible spouse rather than $85.

For 1987, all compensation tax measures for low-income households will amount to $24 000 000.

— Adjustment for aircraft fuel and locomotive fuel oil

Currently, fuel used in aircraft engines and colored fuel oil used for locomotives are taxed at a rate of 8% on the sale price to the user.

The 8% tax raised to 9%

In order to apply to these fuels a tax burden comparable to that applied to other consumer goods under the general sales tax, the tax rate applicable to these fuels will be increased to 9% for fuel purchased after midnight of the evening of the Budget Speech.

This measure represents additional revenues of $1 000 000 for 1986-1987.

Restrictions on the interest and dividend deduction and on the retirement income deduction

Currently, in calculating his taxable income, every individual may deduct a maximum amount of $1 000 for his eligible interest and dividend income. Moreover, a deduction of the same amount is granted a taxpayer who receives certain retirement income. Thus, a taxpayer receiving interest, dividend and retirement income may deduct a maximum amount of $2 000.

Beginning in the 1986 taxation year, only taxpayers considered to be retired may continue to claim the maximum for these two deductions. Elderly persons who are retired and do not earn employment income will not be penalized by this measure. For other taxpayers, these maximums will be reduced by half.

For this purpose, a taxpayer will be considered to be retired once he has reached age 65 or if he receives a retirement pension under the Act respecting the Québec Pension Plan or a pension, supplement or allowance to a spouse under the Old Age Security Act. Moreover, a taxpayer who may claim the retirement income deduction will also be considered a retired taxpayer.

Moreover, when a taxpayer considered to be retired receives income from an office or employment, or from a business he carries on either alone or as an active partner, his maximum deduction will be reduced by $1 000, as follows: if the taxpayer is 65 or over during the year, the interest and dividend deduction, and the retirement income deduction, will be reduced by 50 cents per dollar of income from such activities over $2 200, up to a maximum reduction of $500 per deduction; for other taxpayers, the reduction will be equal to 50 cents per dollar of income from such activities, up to a maximum reduction of $500 per deduction. Thus, the amount that may be claimed under each of these deductions can not fall below the lesser of $500 or the eligible income.

This measure represents $82 000 000 over a full year.

Measures concerning outlying regions

Reduction in the fuel tax

— Extension of peripheral regions

Currently, the fuel tax is one third lower in the following regions: Abitibi-Témiscamingue, Saguenay—Lac-St-Jean, Côte-Nord, Nouveau-Québec and Gaspésie. This reduction represents an amount of more than 4 cents per liter for gasoline and fuel oil.

In order to favor more regions, beginning at midnight of the evening of the Budget Speech, this tax reduction will be extended to other peripheral regions — the western portion of Matapédia county and the northern portion of Laviolette and Gatineau counties.

Furthermore, two specific regions will be added — Rimouski county and the northern portion of Labelle county, where the fuel tax reduction will equal half of that of the peripheral regions.

ILLUSTRATION OF THE REDUCTION IN THE FUEL TAX IN DESIGNATED REGIONS (cents per liter)

	Specific tax before reduction	Tax reduction	
		Peripheral regions	Specific regions
Gasoline			
☐ regular leaded	13.65	4.55	2.28
☐ regular unleaded	14.40	4.80	2.40
☐ super leaded or unleaded	14.70	4.90	2.45
Fuel oil	12.45	4.15	2.08
Propane	8.25	2.75	1.38

The definition of the new designated regions is:

☐ The western portion of Matapédia county: portion of the riding of Matapédia located west of Highway 132.

☐ Rimouski county: riding of Rimouski.

☐ Northern portion of Laviolette county: northern portion of Laviolette riding whose southern limit is determined as follows:
- — beginning at a point located at the southwestern corner of Gosselin township;
- — eastward, following the southern boundaries of the townships of: Gosselin, Choquette, David, Landry, Dandurand, Letondal, Lavigne and Dessane;
- — eastward, southeastward and northeastward, following the southern, southwestern and southeastern boundaries of Lavallée township;
- — northward, following the southeastern boundary of Albani township to where it crosses latitude 48°00'00";
- — from there, eastward following this latitude to where it crosses the boundary separating the ridings of Laviolette and Roberval.

☐ Northern portion of Labelle county: portion of Labelle riding located west of the Lièvre river and including the town of Mont-Laurier in its entirety.

☐ Northern portion of Gatineau county: northern portion of Gatineau riding whose southern boundary is defined as follows:
- — beginning at a point located on the boundary separating Béliveau township in Pontiac riding from Maniwaki township in Gatineau riding;
- — southward along the western boundary of Maniwaki township to the southwestern corner of this township;
- — eastward along the southern boundary of the townships of Maniwaki and Kensinten to where it crosses the boundary separating the ridings of Gatineau and Labelle.

— Increased assistance to retailers in border regions and regions bordering on designated regions

Currently, fuel sold in the border regions and regions bordering on designated regions are taxed at a reduced rate. The amount of this reduction is a function of the distance between the gasoline station and the point of contact with the border or the edge of the designated region.

For the border regions adjacent to a province, gasoline stations must be located less than 20 kilometers from this point to benefit from the reduction. Assistance applied to gasoline sales varies from 33⅓% to 1.27% of the amount of the tax.

For provinces bordering on an American state, gasoline stations must be located less than 3 kilometers from the point of contact and the assistance applicable to gasoline sales is 20% of the amount of the tax.

To enable gasoline retailers located in border regions in contact with American states to be more competitive with their foreign neighbours, the existing rules applying to border regions adjacent to a province will, beginning at midnight of the evening of the Budget Speech, be extended to regions bordering on American states, including the regions of Kamouraska-Témiscouata county in contact with the American state of Maine.

Furthermore, the rate of reduction in the fuel tax for regions bordering on peripheral regions will continue to apply and will be extended to regions bordering on the new peripheral regions. Moreover, for regions bordering on the specific region of Rimouski county and west of the Lièvre river in Labelle county, the reduction will be set at half that for the specific regions for retailers located at least 10 kilometers from the point of contact with these regions.

ILLUSTRATION FOR REGULAR UNLEADED GASOLINE OF THE FINANCIAL ASSISTANCE FORMULA FOR GASOLINE RETAILERS LOCATED IN AREAS BORDERING ON DESIGNATED REGIONS

Distance from point of contact (kilometers)	Rate of Reduction (%)	Assistance ($/liter)
Border regions and regions bordering on peripheral regions		
□ 0 to less than 5	33.33	4.80
□ 5 to less than 10	22.36	3.22
□ 10 to less than 15	12.24	1.76
□ 15 to less than 20	1.27	0.18
Regions bordering on specific regions		
□ 0 to less than 10	8.33	1.20

— Implementation of changes

Fuel retailers in the new designated regions, border regions and areas bordering on designated regions must draw up a complete list of the fuel they have on hand on the evening of the Budget Speech. The ministère du Revenu will use a form to gather this information and, if applicable, will give a rebate on the tax differential between the former rate and the new one taking into account the amount advanced as working capital.

Wholesalers mandated by the ministère du Revenu to collect the tax must, in the case of fuel delivered after midnight of the evening of the Budget Speech to gasoline retailers or consumers located in these new regions, collect and pay the tax at the new rate. In other cases, they must collect the full amount of the specific tax.

Wholesalers who are not under contract with the ministère du Revenu to collect and pay the tax will be entitled to a reimbursement in the sum of the reduction of the specific tax for fuel delivered after midnight of the evening of the Budget Speech to gasoline retailers or consumers located in these new regions.

The tax reductions in these new regions will, however, apply only if the fuel is transferred directly to a tank supplying the engine of a motor vehicle or to a container with a capacity not exceeding 205 liters, or if it is delivered directly to a consumer into a fixed storage tank located in a newly specified region.

— Special credit for the taxi industry

Since 1984, persons holding a taxi-vehicle licence on December 31 are entitled to a tax credit of $500 per taxi-vehicle. This tax credit is aimed at offsetting a portion of the fuel tax and is to be shared with drivers having to bear the cost of gasoline. In order to take account of the tax reductions in border regions, new peripheral regions, specific regions or regions bordering on peripheral regions or specific regions, holders of a taxi-vehicle licence granted for these regions may no longer benefit from this special tax credit of $500 for the 1986 taxation year and subsequent years.

— Financial impact

All the measures concerning the extension of designated and border regions contemplated by the decrease in the fuel tax represent, for fuel users in these regions, a reduction in their tax burden of $5 000 000 for the next twelve months.

Reduction in the tax on capital

— *Corporations in the fishery sector*

Currently, a corporation working in the fishery sector must pay a general tax of 0.45% of its paid-up capital.

$300 000 deduction

Beginning in their taxation year ending after the day of the Budget Speech, corporations whose activities consist mainly in operating a commercial fishery will be able to deduct an amount of $300 000 in calculating their paid-up capital. However, for such corporations, the tax may in no case be less than $50. For taxation years overlapping the day of the Budget Speech, this deduction will apply proportionally to the number of days of the taxation year which follow the Budget Speech.

— *Associated corporations eligible for the $300 000 deduction*

In terms of the tax on capital, corporations whose activities consist mainly in operating an agricultural enterprise currently benefit from a $300 000 deduction in calculating their paid-up capital. This deduction is extended in this Budget Speech to apply to corporations whose activities consist mainly in operating a commercial fishery.

Anti-avoidance rules

In order to prevent an incorporated enterprise from splitting into several corporations simply to benefit from more than one $300 000 deduction, anti-avoidance rules will be introduced.

Therefore, this deduction will be $300 000 unless the corporation is associated with one or more other corporations whose activities consist mainly in operating an agricultural enterprise or a commercial fishery. In this case, the deduction will be zero, unless all the associated corporations have indicated an allocation, for the taxation year, of an amount to one or more of them, and this amount, or the total of the amounts allocated in this manner, does not exceed $300 000. The deduction that each of the corporations may claim in the calculation of its paid-up capital will correspond to the amount allocated to it in this way.

This measure will apply to taxation years ending after the day of the Budget Speech.

Special deduction for residents of the Far North and of designated isolated posts

Currently, some employees working in Northern Québec or in designated isolated posts are exempt from income tax with regard to certain tax benefits for housing and transportation paid by their employer. The tax treatment accorded by Québec legislation to these workers is both different and more generous than that currently granted by federal legislation. This will continue to be the case until January 1, 1987, when the new federal measures become effective

Housing

In his Budget Speech of February 26, the federal Finance Minister announced an important change in the tax treatment of such benefits. He announced that beginning on January 1, 1987, all persons residing in the Far North and in designated isolated posts for a continuous period of at least 6 months, will benefit from a special deduction for housing in the calculation of their taxable income. This deduction, which cannot exceed 20% of income, will equal $225 per month for each individual. However, for each month that the taxpayer maintains and lives in an independent domestic establishment, the deduction will be $450 per month.

Trips

In this Speech, the federal Finance Minister also proposed to implement, for each employee, a deduction for trips for medical purposes or for vacations. This deduction will equal the cost of return economy-class airfare for the employee and his family to the closest designated town. However, for vacation trips, the deduction will be limited to the expenses incurred for two trips per year.

Concordance

In order to improve the current tax treatment of residents of Northern Québec and designated isolated posts, and to avoid adding to the complexity of tax legislation, the Québec income tax system will be brought into line with that of the federal government for tax deductions for housing and trips for residents of the Far North and designated isolated posts. This measure will become effective with the same dates, conditions, persons and places as those contemplated in the federal legislation.

$23 000 000 benefits

These deductions represent an additional reduction in the cost of housing and transportation of approximately $23 000 000 for residents of the Far North and designated isolated posts located mainly in the counties of Ungava and Duplessis, as well as in many other counties in Québec.

Improvements in the municipal road network

$10 000 000 more in 1986-1987

Additional estimates of $10 000 000 will be presented in the National Assembly for element 4 of Program 5 of the ministère des Transports, "Assistance for Municipal Network Improvement". Total appropriations devoted to this program in 1986-1987 will reach $22 178 600.

Regional Development Fund

$10 000 000 more in 1986-1987

Additional estimates of $10 000 000 will be presented to the National Assembly for element 1 of Program 2 of the Office de planification et de développement du Québec, "Regional Development Fund". Total appropriations devoted to this program in 1986-1987 will thus reach $22 359 000.

Tax adjustments related to the capitalization of business firms

The Québec Stock Savings Plan (QSSP)

— Conditions related to share issues

Currently, to be eligible for a Québec Stock Savings Plan, a share cannot, in under the conditions pertaining to its issue, be purchased or redeemed by the corporation issuing it or by any other corporation. This does not, however, prevent the issuing corporation from providing for the redemption of shares by other persons, such as the corporation's directors. A corporation may also issue shares whose conditions of issue could provide that a third party guarantees the payment of large dividends; such a condition would not prevent shares from being eligible for the QSSP.

Given that such arrangements may result in the risk associated with purchasing the security not corresponding to the security's rate of deduction, there is reason to apply corrective measures so that this rate reflects the risk borne by the shareholder.

QSSP reserved for securities with risk element

Therefore, under the conditions pertaining to its issue, to be eligible for the QSSP, a share may henceforth not be purchased or redeemed by anyone, in any manner whatsoever, notably by reducing the paid-up capital related to the

share, reorganization of capital, an exchange of shares, a sale option, a merger, or a conversion other than a conversion concerning an eligible preferred share.

Moreover, under the conditions pertaining to its issue, the share may no longer include, for shares to be eligible for the QSSP, a commitment to the effect that dividends will be paid for these shares and that a person other than the issuing corporation guarantees the payment of these dividends.

This measure will apply to share issues beginning after the Budget Speech namely, whose final prospectus, or exemption from filing a prospectus, has been received after the day of the Budget Speech.

— Value of property held by an eligible corporation

Currently, investment corporations are not eligible for the Québec Stock Savings Plan. For this purpose, an investment corporation is a corporation more than 50% of the value of whose property is composed of shares, debentures, bonds, etc.

Since the term "share" is included in this list, investment dealers corporations having, for example, underwritten issues may, after having calculated the value of their assets composed of investment securities such as shares, exceed the 50% limit after having taken into consideration the shares included in their assets acquired as a result of such an underwriting. Therefore, they could not issue shares eligible for the QSSP since they would be considered as investment corporations even if they do not, in fact, currently hold these shares for themselves.

Investment dealer corporations

In order to permit investment dealer corporations to use the QSSP as a vehicle in the same way as any other corporation otherwise eligible, the shares that an investment dealer corporation holds in its inventory will not be taken into account in calculating the value of its property to determine whether or not it is an investment corporation. However, shares held in inventory will continue to be taken into account in determining the assets of such a corporation.

This measure will apply to share issues beginning after the Budget Speech.

— Rule for the last taxation year

To be eligible for the QSSP, a corporation must respect certain limits that must be calculated during its last fiscal year ending before the date of receipt of the final prospectus. This is the case for the limit related to the amount of a corporation's assets and that of the net shareholders' equity. This also applies to the calculation conducted under the rule according to which not more than 50% of the value of an eligible corporation's property may be composed of certain securities. In these cases, the data taken into consideration are those appearing in the books and financial statements submitted to the corporation's shareholders for its last taxation year ending before the date of receipt of the final prospectus or the exemption from filing a prospectus.

Fiscal year-ends

Given the fact that a corporation sometimes changes its fiscal year-end solely to qualify as a corporation eligible for the QSSP, henceforth, in order to ensure that the tax treatment accorded a corporation that changes the end of its fiscal year is the same as that reserved for those retaining the same date for the end of their fiscal year, the data taken into consideration will be those appearing in the books and financial statements submitted to the corporation's shareholders for each of the taxation years ending in the twelve months preceding the date of receipt of the final prospectus or the exemption from filing a prospectus.

This measure will apply to share issues beginning after the Budget Speech. However, issues for which the work surrounding the preparation of the prospectus or the application for exemption from filing a prospectus is sufficiently well advanced on the date of the Budget Speech may proceed according to the former rules, notwithstanding this measure. To this effect, a request for an advance ruling or filing of a provisional prospectus will be considered and issuers wishing to benefit from this transitional rule must justify their application in writing to the ministère du Revenu within the twenty days following the day of the Budget Speech.

— Employees of the eligible corporation

To be eligible for the QSSP, a corporation making a public share issue must, at the date of receipt of the final prospectus or the exemption from filing a prospectus, have at least five full-time employees who are not insiders. Moreover, in order to be considered a developing corporation, a corporation must have had, over the twelve months preceding the date of receipt of the final prospectus or of the exemption from filing the prospectus, at least five full-time employees who were not insiders.

Minimum of five full-time employees

In order to standardize the conditions of eligibility regarding the number of employees for all issuers, from now on, to be eligible for the QSSP, a corporation must, over the twelve months preceding the date of receipt of the final prospectus or of the exemption from filing a prospectus, have had at least five full-time employees who are not insiders. Special rules will be introduced to take account of new corporations resulting from a merger.

Furthermore, the requirement as to the number of employees will be made even stricter. From now on, employees of developing or other corporations may not be related to insiders of such corporations.

This measure will apply to share issues beginning after the Budget Speech. However, issues for which the work surrounding the preparation of the prospectus or the application for exemption from filing a prospectus is sufficiently well advanced on the date of the Budget Speech may proceed according to the former rules, notwithstanding this measure. To this effect, a request for an advance ruling or filing of a provisional prospectus will be considered and issuers wishing to benefit from this transitional rule must justify their application in writing to the ministère du Revenu within the twenty days following the day of the Budget Speech.

— Shares acquired by exercising a warrant

When a share eligible for the QSSP is issued by a corporation whose assets are less than $1 000 000 000 and the share is acquired by exercising a warrant, a deduction may be claimed at the rate in effect the year the warrant was acquired, even if such share would have entitled the holder to a different rate of deduction had it been acquired other than by exercising a warrant. However, when such a share is issued by a corporation whose assets equal $1 000 000 000 or more, a deduction may be claimed at the same rate whether it is purchased directly or by exercising a warrant.

In order to standardize the tax treatment of warrants, henceforth, a share purchased by exercising a warrant will entitle the holder to the deduction rate applicable to this share the year the warrant is exercised and not the year it was acquired.

This measure will apply to warrants granted as part of issues beginning after the Budget Speech.

— Eligible shares purchased or redeemed by the issuing corporation

To be eligible for the Québec Stock Savings Plan, a share cannot, under the conditions pertaining to its issue, be purchased or redeemed. Thus, the holder of such a share cannot demand that the issuing corporation redeem it any more than the issuing corporation can redeem it unilaterally. Nevertheless, nothing prevents the issuing corporation from making a public offer to redeem its securities.

In order to encourage issuing corporations to retain the proceeds of their issues eligible for the QSSP as permanent capital, and thus to avoid having operations or transactions develop whose sole aim is to reap a tax benefit, new rules will be introduced.

To begin with, any corporation having, at any time, issued shares under the Québec Stock Savings Plan and which, after the day of the Budget Speech, purchases or redeems, in any manner whatsoever, directly or indirectly, shares subject to a stipulation that they may be included in a QSSP, no longer be a corporation eligible for the QSSP. This restriction will apply for as long as it has not floated a share issue, which would otherwise be eligible for inclusion in a QSSP, for an amount equal to that of the redemption.

Purchase and redemption penalized

Moreover, if such purchases or redemptions dealt with shares in a class that was issued under the QSSP beginning during the two calendar years preceding the year of purchase or redemption, a penalty of 25% of the average adjusted cost of such purchased or redeemed shares must be paid by the corporation. However, this penalty applies only up to the lesser of the following:

1- 25% of the average adjusted cost of the purchased or redeemed shares, or

2- 25% of the average adjusted cost of all shares of the class that was subject to a stipulation to the effect that they could be included in the QSSP.

For the purposes of this measure, a share which has not been issued under the QSSP but which belongs to a class of shares subject to such a stipulation will be deemed to have been issued under the QSSP.

— Investment corporations

Since 1979, when the Québec Stock Savings Plan was introduced, eligible share issues have been floated without the government judging it appropriate to demand a report or supervise the use of the funds amassed through these share issues. Moreover, until very recently, it was observed that the very great majority of these issues were consistent with the many objectives of the plan, that is, facilitating the financing of projects, in particular through permanent capital.

The continually increasing demand for QSSP securities has resulted, in certain cases, in a multitude of strategies for artificially increasing the supply of securities. The use to which corporations put these sums does not always justify the cost to Québec taxpayers of the tax benefit granted. In this respect, the sustained growth of the cost of this tax allowance therefore fully justifies ensuring taxpayers that only those share issues whose proceeds produce concrete economic activities which create jobs may henceforth occur under the Québec Stock Savings Plan.

This is why, beginning immediately, share issues which would otherwise be eligible for the QSSP will no longer be eligible when the acknowledged use of the major portion of the issue proceeds is the direct or indirect payment for the purchase of shares of another corporation or of any other easily negotiable security. Nevertheless, an exception is granted if this purchase consists, in the case of securities with voting rights, of a block large enough for the issuing corporation to acquire in this way a "controlled subsidiary" within the meaning of the Taxation Act, that is after the transaction, the issuing corporation owns over 50% of the issued capital stock of the acquired corporation with full voting rights under all circumstances. In addition, the activities of the "controlled subsidiary" must have commercial possibilities directly linked to the issuing corporation's activities. Finally, the issuing corporation must carry on an eligible business either directly or through a subsidiary.

For the purposes of this measure, the proceeds of a share issue which are used to repay a loan contracted over a reasonable period from the date of the beginning of the issue for the payment of shares or any other easily negotiable security, will be deemed to have been used to pay for the purchase of shares or any other easily negotiable security.

This measure will apply to share issues beginning after the day of the Budget Speech. However, issues for which the work surrounding the preparation of the prospectus or the request for exemption from filing a prospectus is sufficiently well advanced on the date of the Budget Speech may proceed according to the former rules, notwithstanding this measure. To this effect, a request for an advance ruling or the filing of a provisional prospectus will be considered and issuers wishing to benefit from this transitional rule must justify their application in writing to the ministère du Revenu within the twenty days following the Budget Speech.

— Advance rulings

The ministère du Revenu du Québec renders advance rulings informing taxpayers ahead of time of the tax treatement reserved for the operations they envisage. Such rulings are rendered under the QSSP in order to confirm, among other things, the eligibility of corporations and shares for the plan as well as the rate of deduction they will entail.

To assure taxpayers that the funds raised by corporations under the Québec Stock Savings Plan will be raised according to the program's objectives, the ministère du Revenu will no longer render an advance ruling when, in its opinion, the funds amassed from the proceeds of the issue will not be raised in accordance with the objectives of the Québec Stock Savings Plan.

Moreover, the Commission des valeurs mobilières du Québec will have to require the issuing corporation to inform potential buyers of whether or not it has requested an advance ruling from the ministère du Revenu regarding this issue as well as the resulting ruling.

These measures will apply to share issues beginning after the Budget Speech.

— Penalties

Currently, a corporation that contravenes QSSP provisions incurs a penalty equal to 20% of the adjusted cost of the shares of the issue about which the corporation has made false declarations.

Penalties increased to 25%

Henceforth, penalties concerning the QSSP will be set at 25% of the adjusted cost of the shares in question. This measure will permit a better matching of the rate of these penalties with the value of the tax benefit obtained under the QSSP.

This new penalty rate will apply after the Budget Speech.

— Technical modifications

Certain technical modifications will also be made to the Québec Stock Savings Plan in order to specify:

- ☐ that a common share with full voting rights or a subordinate voting share resulting from the conversion of an eligible preferred share issued by a developing corporation cannot, under the conditions related to the issue of the preferred share, be purchased or redeemed by anyone, in whole or in part, in any manner whatsoever;

- ☐ that the promissory notes and all other debt securities be included in the list of property whose value must not represent more than 50% of the value of a corporation's property for it to be a corporation eligible for the QSSP;

- ☐ that a share may be eligible for the QSSP even if the issuing corporation must stipulate, in the conditions concerning its issue, in accordance with an act or general regulation, that this share is redeemable under certain circumstances;

- ☐ that for the purposes of determining a corporation's assets, it will henceforth be assumed that no expenditure whatsoever was incurred by a corporation to purchase an intangible asset when the consideration for the purchase of this intangible asset was shares from the corporation's capital stock;

- ☐ that a corporation governed by the Act respecting Sociétés de placements dans l'entreprise québécoise cannot be a corporation eligible for the QSSP; and

- ☐ that a share purchased under the QSSP is a share purchased for money consideration.

These measures will apply to share issues beginning after the Budget Speech.

Sociétés de placements dans l'entreprise québécoise (SPEQs)

— Extension of the criterion of wages paid in Québec

Currently, shareholders of a SPEQ enjoy tax benefits when the company undertakes an eligible investment in an eligible corporation. To qualify as an eligible corporation, a corporation must, among other things, over the 12 months preceding the investment, have paid more than 75% of its wages to employees of an establishment located in Québec, including wages to employees of corporations with which it is associated.

In order to ensure that the investments by a SPEQ actually benefit eligible corporations remaining in Québec for at least the minimum two-year holding period for such an investment, the requirement to the effect that more than 75% of the wages must have been paid to employees of an establishment located in Québec during the 12 months preceding the investment will also

apply to the two years following the investment. The penalty of 30% of the amount of the investment will apply to the eligible corporation in cases where this rule is not respected.

This measure will apply immediately after the Budget Speech.

— Maintenance of the minimum paid-up capital of a SPEQ

A SPEQ must show, at the time of its registration, that the common shares with full voting rights of its capital stock were subscribed and paid for for an amount of not less than $100 000. This does not mean that a SPEQ that met this requirement at the time of its registration cannot subsequently reduce the paid-up capital in regard to its shares.

To be certain that SPEQs continue to maintain this minimum level of capital throughout an eligible investment, rules will be introduced for the registration of a SPEQ to be nul and void as soon as the paid-up capital of a SPEQ falls below $100 000 during the term of an eligible investment. Consequently, the general penalty applicable to a SPEQ whose registration becomes nul and void, equal to 30% of the eligible investment, will apply.

This measure will apply as soon as the act introducing it comes into effect.

— Tightening the rules governing non-arm's-length dealing

The Act respecting sociétés de placements dans l'entreprise québecoise stipulates that a SPEQ's investment cannot be eligible if the SPEQ does not deal at arm's length with the corporation in which it invests.

To determine whether or not the SPEQ and the corporation in which it invests are dealing at arm's length, the voting shares of the corporation's capital stock held by the SPEQ are added to those held by a majority shareholder of the SPEQ. If, together, the shareholder and the SPEQ hold 50% or more of the voting shares of the eligible corporation's capital stock, the corporation and the SPEQ are considered not to be dealing at arm's length.

Despite this requirement, it is possible for the shareholders of an eligible corporation to use SPEQs as a vehicle for investing in their corporation without having a third party contributing new funds.

To prevent the occurrence of such investment situations which fail to bring about any actual contribution of capital, henceforth, the shares considered will be those held by the shareholders of the eligible corporation which also together hold 50% or more of the SPEQ's shares. To determine whether there is non-arm's-length dealing, voting shares held in an eligible corporation by any shareholder of a SPEQ or of an associated corporation will also be taken into account whether these voting rights are held directly or indirectly by the shareholder.

However, so as not to hinder investments made under circumstances in which a SPEQ and an eligible corporation actually deal at arm's length, the voting rights that any shareholder of a SPEQ or of a corporation associated with him, or any person affiliated with such a shareholder, holds in an eligible corporation in which the SPEQ has invested will not be taken into account to determine whether a SPEQ and an eligible corporation are not dealing at arm's length, provided all voting rights held by such shareholders in the SPEQ amount to less than 50% of the total voting rights held in the SPEQ.

This measure will apply to all investments carried out by a SPEQ after the Budget Speech.

— Supplementary conditions on eligible investments

To be considered an eligible investment by a SPEQ, the investment must be made in ordinary shares with full voting rights of the capital stock of an eligible corporation, which the SPEQ has acquired as a first purchaser.

Therefore, this rule does not prevent two individuals, each controlling a corporation, from each creating a SPEQ to invest in the other's corporation.

To prevent such transactions from occurring, the legislation and regulations governing SPEQs will be amended to disqualify an investment in an eligible corporation by a given SPEQ, if a shareholder of the eligible corporation is a shareholder of another SPEQ which has invested, or invests during the two years following the investment, in an eligible corporation, one of whose shareholders is also a shareholder of the given SPEQ. In addition, rules will be introduced to ensure that such transactions may not be effected indirectly through persons not dealing at arm's length.

This measure will apply to investments made by a SPEQ after the Budget Speech.

— Limit on amounts deductible

A taxpayer who acquires a common share with full voting rights in the capital stock of a SPEQ may claim a deduction in calculating his taxable income when the SPEQ makes an eligible investment. The amount of the deduction the taxpayer is entitled to must be determined on the basis of his share in the eligible investment. Currently, this share is obtained by applying to the eligible investment the proportion of the paid-up capital represented by common shares of the SPEQ with full voting rights owned by the taxpayer to the total paid-up capital of the SPEQ represented by common shares with full voting rights.

Since the SPEQ may obtain funds from sources other than common shares with full voting rights, such as loans or preferred shares, it may make an eligible investment for an amount greater than the paid-up capital represented by common shares with full voting rights. In addition, the deduction granted to a shareholder may exceed the total of his investment in common stock with full voting rights and of his commitments to the SPEQ in the form of loans or other securities.

To prevent the tax deduction granted in regard to an investment by a SPEQ from exceeding the total amount of the shareholder's financial commitments in the SPEQ, from now on, such deduction will be limited, for each shareholder, to his share of the eligible investment as determined according to existing rules. However, for each investor, such deduction shall not exceed the amount such investor has actually invested or pledged in the SPEQ as share capital, loans, pledges or other real investments.

This measure will apply to every eligible investment by a SPEQ after the Budget Speech.

— Utilization of funds received from a SPEQ

Currently, regulations governing SPEQs prevent an eligible corporation from making significant withdrawals of funds for the benefit of shareholders during the two years preceding the date of an eligible investment and during the term

of the investment, except with the approval of the Société de développement industriel du Québec.

However, an eligible corporation can lend money to persons who then form a SPEQ to make an eligible investment in this eligible corporation. In this case, a tax benefit is granted, although no new money is invested in the eligible corporation.

To correct this situation, the regulations governing SPEQs will be amended to provide that during the two years preceding the date of an eligible investment and during the term of such investment, a corporation may not make any large withdrawal of funds for the benefit of its shareholders or for shareholders of a SPEQ which has made this investment, or for the benefit of persons who are affiliated with these shareholders.

Furthermore, as matters stand now, an eligible corporation may not use the funds in an eligible investment during the two years following such investment to repay a creditor who is a shareholder of the SPEQ or of the eligible corporation, or a person with whom this creditor does not deal at arm's length. However, there is nothing to prevent an eligible corporation from repaying a creditor who is a corporation with which it is associated but which is not a shareholder of the SPEQ or of the eligible corporation.

To prevent such repayment, henceforth, an eligible corporation may not use the proceeds of an eligible investment during the two years following such an investment to repay a creditor who is a corporation with which it is associated.

These measures will apply to investments made by a SPEQ after the Budget Speech.

— ***Technical modifications***

Other technical modifications will also be made to the rules governing Sociétés de placements dans l'entreprise québécoise to:

- ensure that the Société de développement industriel du Québec is charged with certifying the eligibility of an investment so that it may be considered as an eligible investment. This condition is added to the definition of "eligible investment" to invest the ministère du Revenu with the power to require such certification before granting a deduction for an investment in a SPEQ;

- harmonize the expressions used in the Act respecting Sociétés de placements dans l'entreprise québécoise and in the Taxation Act. The definition of "participation in an eligible investment" in the Taxation Act will be added to the Act respecting Sociétés de placements dans l'entreprise québécoise;

- provide that any penalties applicable to Sociétés de placements dans l'entreprise québécoise will also apply to such companies that are no longer duly registered;

- ensure, for the purposes of the definition of a common share with full voting rights, that there is no condition relative to the cost of the share;

- specify that not only may a share which is part of an eligible investment not be redeemed, but neither may it be purchased by the eligible corporation during the five years following its acquisition by a SPEQ; and

- ensure that the funds of an eligible investment cannot be used by an eligible corporation during the two years following such an investment to purchase shares of the eligible corporation. Currently, only redemption is provided for under such circumstances.

These measures will become effective after the Budget Speech.

The Cooperative Investment Plan (CIP)

Currently, an individual member or worker belonging to an eligible cooperative who acquires a security eligible under a Cooperative Investment Plan (CIP) may, under certain conditions, deduct 100% of his investment in calculating his taxable income.

So that members of cooperatives who carry on their business as a partnership may encourage the contribution of permanent capital in farm cooperatives, partnerships belonging to a farm cooperative may, beginning in the 1986 taxation year, acquire securities eligible for inclusion in a CIP. For the purposes of the tax deduction, individual members of the partnership who are in a position, individually, to participate in the activities of the farm cooperative, will be deemed to have acquired securities eligible for inclusion in the plan for an amount equivalent to the amount obtained by applying the percentage of their participation in the profits of the partnership for the year to all the securities acquired by the partnership during the year.

The existing rules governing redemption of securities by the cooperative will apply, with the following adaptations:

- shares acquired by a partnership may only be redeemed beginning in the year after the three years following their issue, and provided the reserve appearing in the cooperative's financial statements at the end of the last fiscal year preceding the issue is increased by at least 50% of the redemption amount;

- in the case of a member aged 65, or 60 if he is retired, who withdraws from the partnership, the redemption of securities by the cooperative, for an amount equal to the amount of the tax deduction attributed to such member, may not be effected, as provided for under the general rule, until the year after the three years following their issue. However, to facilitate redemption in such circumstances, the requirement of increasing the reserve may be satisfied by the cooperative in a subsequent year, but before any further redemption; and

- finally, a cooperative may, at any time, redeem the securities of a partnership for an amount equal to the amount of the tax deduction which has been granted to a member of the partnership following his death, disability or interdiction.

This measure will apply to all shares acquired after the Budget Speech.

Restriction to the Loans for Capitalization Program (LCP)

The Loans for Capitalization Program introduced in the Budget Speech of April 23, 1985, is to expire December 31, 1986. The two-fold objective of this program is to encourage capital growth in the financial structure of small and medium-sized businesses in Québec operating in certain sectors of activity, and to facilitate the development of dynamic small and medium-sized

businesses whose activities have significant economic spinoffs for the economy of Québec.

Under this program, Québec business firms may currently receive a loan for capitalization to undertake a start-up or expansion project at least 50% of which is made up of capital expenditures, provided there is a contribution of new permanent capital in the firm of at least an equivalent amount.

Limit on accumulation of programs

To ensure that these new funds will not be obtained from government financial assistance programs, from now on, such funds may no longer be obtained, either directly or indirectly, from government programs such as "Business Grants Program for Young Businessmen" or "Croissance locale de l'emploi (CLE)".

Moreover, the Société de développement industriel du Québec (SDI) currently considers that a project involves "significant economic spinoffs" when it targets a vigorously expanding market, either in an import replacement context or in relation to an export market.

Financial assistance limited to capital expenditures

To focus the program more accurately on its objectives and avoid an accumulation of assistance in regard to certain eligible expenditures, from now on, financial assistance under the loans for capitalization program will only be granted for capital expenditures, thus excluding any amount designed to create or increase working capital. The expression "eligible expenditure" will therefore be amended so that only those capital expenditures will be considered as eligible expenditures for which no financial assistance in the form of grants or other similar assistance, has been paid by any other source within the Québec government in relation to those same expenditures.

These measures will apply to applications for financial assistance submitted to the SDI after the day of the Budget Speech.

Elimination of part of the Financial Assistance Program for the Capitalization of Corporations

The Financial Assistance Program for the Capitalization of Corporations, introduced in 1983, is due to end on March 31, 1988. It is designed to facilitate the first public distribution of shares of corporations by reducing their cost of entering the public share market. The program is divided into two parts. The first covers a portion of the costs relative to the feasibility study for a public issue of shares; the amount of assistance is equal to 50% of the costs of the study, to a maximum of $10 000. The second part covers a portion of the costs of launching and the issue expenses involved in a first issue. The total assistance, in this regard, may reach $400 000 for an issue of shares of $3 000 000 or more.

Since the lively interest shown by Quebecers in the Québec Stock Savings Plan has driven down the cost of entering the public market, the second part of the program, namely the part covering costs of launching and issue expenses, will be eliminated in regard to share issues floated after the Budget Speech, except those for which a provisional prospectus has been obtained before the Budget Speech.

As for the first part, dealing with the partial reimbursement of costs in regard to a feasibility study, it will continue in its present form.

Miscellaneous measures

Conversion of "ad valorem" taxes into specific taxes

— Fuel tax

Currently, the fuel tax is expressed as a percentage of the average sale price of the fuel.

Beginning at midnight on the evening of the Budget Speech, the 30% "ad valorem" tax on fuel is replaced by a specific tax per liter whose effective amounts will equal those presently in effect. In addition, from now on, the National Assembly must approve any change in the tax.

ILLUSTRATION OF AMOUNTS OF THE TAX
(cents per liter)

	Amount of the tax
Gasoline	
□ Regular leaded	13.65
□ Regular unleaded	14.40
□ Super leaded or unleaded	14.70
Fuel oil	12.45
Propane	8.25

Moreover, the refund paid to common carriers for that part of the tax which, prior to the introduction of this measure, exceeded 20%, will be maintained and expressed on the basis of the specific tax.

— Tobacco tax

Beginning at midnight on the evening of the Budget Speech, the "ad valorem" tax of 60% applied to cigarettes is replaced with a specific tax of 4.52 cents per cigarette, the current amount of the tax. As to the tax applicable to the sale of tobacco other than cigarettes and cigars, it is replaced by a specific tax of 2 cents per gram. The National Assembly must, from now on, approve any change in the tax. Finally, the "ad valorem" tax will continue to apply to cigar sales because of the significant price differentials for this product.

Refund of the fuel tax to Indians

Indians and Indian bands will be entitled to a refund of the fuel tax for fuel purchased after midnight of the evening of the Budget Speech, for their own consumption, at a retail distribution establishment located on a reserve and operated by a holder of a registration certificate.

Refund applications must be submitted to the ministère du Revenu in accordance with the prescribed form and conditions.

Indians and Indian bands will benefit to the extent of over $2 000 000 per year from this measure.

Sales tax on insurance premiums

— Exemption for aircraft insurance premiums

Currently, the retail sales tax applies to aircraft insurance premiums.

From now on, the tax will not apply to insurance premiums for aircraft, used in carrying on a commercial airline service, paid after midnight on the evening of the Budget Speech.

— Taxation of reciprocal insurance

Currently, the 9% retail sales tax does not apply to the premium payable under a reciprocal insurance contract.

To avoid conferring a tax advantage to certain types of insurance compared to others, the tax will apply to premiums paid under a reciprocal insurance contract after midnight of the evening of the Budget Speech.

— Introduction of a tax-free threshold

The retail sales tax does not apply to sales of 25 cents or less, except insofar as this tax applies to insurance premiums, for which there is no exemption.

To simplify the application of the sales tax to insurance premiums, the 25-cent exemption will be extended to cover insurance premiums, when such premiums are single premiums payable in a single payment, or when the total premiums for one year do not exceed this amount.

This measure will apply as of midnight of the evening of the Budget Speech.

Taxation of income from an eligible business firm

— Savings and credit unions

In a Statement delivered by the Minister of Finance on December 17, 1982, concerning the concordance of the federal and Québec tax systems, it was announced that a technical modification would be introduced to Québec's tax legislation to ensure that the "base amount" used in the calculation of the federal small business deduction granted to a corporation in the calculation of its tax payable would remain taxable at a rate of 3% under Québec legislation as of the 1982 taxation year. This measure was taken to prevent the effective Québec tax rate on this amount from being higher for certain corporations for the 1982 and subsequent taxation years than it had been in the 1981 taxation year. The tax legislation has since been amended and these changes are included in sections 771.3 and 771.4 of the Taxation Act.

So that the tax treatment of savings and credit unions is similar to that granted to corporations affected by the announcement in the Statement of December 17, 1982, a measure will be introduced such that the "base amount" used in calculating the supplementary federal deduction which a savings or credit union may deduct from its tax payable will remain taxable at a 3% Québec tax rate for 1982 and subsequent taxation years. As a result, a savings or credit union may benefit from the reduced rate on all its sources of income as long as it has not reached, for all practical purposes, a total amount of income taxable at a reduced rate equal to 5% of its maximum cumulative reserve.

— Service and management corporations

Frequently, a corporation that is a subsidiary of another corporation carries on a manufacturing business, while the assets needed to carry on the business are held by the other corporation. In such a case, federal legislation, and Québec legislation with respect to the portion of income eligible for the small business deduction, permit amounts paid by the operating corporation to the other

corporation and deducted by the operating corporation in calculating its income from an active business to maintain their status as income from an eligible corporation. This enables this type of income to benefit from a reduced tax rate for the first $200 000 of such annual income earned by a corporation or by a group of affiliated corporations.

However, as soon as the total of the income earned by the management corporation under the circumstances described above and the eligible income of the operating corporation exceeds $200 000, in certain cases, the income considered to be derived from an eligible business may once again be considered not be derived from an eligible business and, thus, be taxed at the 13% rate, that is, the rate for investment income.

To increase the neutrality of Québec taxation as to the organization of firms within a group, a definition of the expression "income derived from an eligible business" will be added to Québec's tax legislation and regulations to allow a corporation to treat certain income as income from an eligible business which would otherwise not be considered to be such.

Thus, beginning in the 1987 taxation year, the existing limited measure, contained in sections 771.3 and 771.4 of the Taxation Act, will be expanded to apply to the eligible business income of all companys, so that the 5.5% tax rate will apply to the portion of a corporation's income corresponding to an amount that an associated company will have deducted in calculating its income obtained from a eligible business for a taxation year.

Technical modifications concerning the taxation of government corporations

Under the tax legislation, government corporations at least 90% owned by the federal government, a province or a Canadian municipality are exempt from income tax and the tax on capital, as are their wholly owned subsidiaries, except prescribed government corporations which are taxable. Several government corporations carrying on a business of a commercial nature are prescribed and thus have been taxable for several years.

The legislation is worded in such a way as to give the impression that certain government corporations that are not agents of the government cannot be prescribed and thus made taxable.

To correct this situation, the tax legislation will be amended to specify that currently prescribed government corporations are taxable. This modification will apply in a declaratory manner except for cases pending before the Courts on the day of the Budget Speech.

Tourism advertising

To promote tourism development in Québec during fiscal 1986-1987, an amount of $1 000 000 has been added to the appropriations of the ministère du Tourisme.

Concordance with federal legislation and regulations

Tax treatment of dividends

In his 1986-1987 Budget Speech, the federal Minister of Finance announced that the gross-up rate for dividends, for purposes of inclusion in the calculation of a taxpayer's income, would fall from 50% to 33⅓% of the dividend received and that, consequently, the rate for the dividend tax credit would be reduced

from 22²/₃% to 16²/₃% of the grossed-up dividend. These amendments are to become effective as of the 1987 taxation year.

To continue harmonizing the tax treatment of dividends received by taxpayers in Québec with the tax treatment of dividends received by taxpayers in other provinces, the gross-up rate and the dividend tax credit rate will fall, as of the 1987 taxation year, from 50% to 33¹/₃% of the dividend received and from 16²/₃% to 11.08% of the grossed-up dividend.

This measure will generate additional revenue of the order of $44 000 000 over a full year.

$500 000 lifetime capital gains exemption

In his 1985-1986 Budget Speech, the federal Minister of Finance announced a measure giving preferential tax treatment for realized capital gains by introducing a lifetime $500 000 capital gains exemption. The measure is to come into effect over a period of six years, and Québec's tax system was brought into line with this measure for amounts due to come into effect during the first two years of its application, namely an amount of $20 000 in 1985 and $50 000 in 1986. A decision as to concordance in subsequent years was to be taken later.

So that Québec's tax system remains competitive with those of other provinces, its tax legislation will be fully harmonized with federal tax legislation in regard to the lifetime capital gains exemption. The ceilings for the lifetime capital gains exemption will be $100 000, $200 000, $300 000 and $500 000 respectively for 1987, 1988, 1989 and 1990 and subsequent years.

Measures in the 1986-1987 federal Budget Speech and other measures

On February 26, 1986, the federal Minister of Finance tabled a notice of ways and means motion in the House of Commons to amend the federal Income Tax Act. In this regard, Québec's tax legislation and regulations will be amended so that the federal and Québec tax systems are in closer harmony. However, these concordance measures will only be adopted once all the federal legislation resulting from the notice of ways and means motion has been passed and will be applicable on the same dates as for the purposes of the federal income tax.

These concordance measures appear in the following list. Some of them have already been mentioned in this Appendix. This is the case, among others, for measures dealing with residents of the Far North and designated isolated posts, and the tax treatment of dividends.

However, some provisions announced by the federal government have not been applied because existing Québec legislation is satisfactory. This is true of the measure dealing with the married person's exemption (RB 5),* the increase in the deduction for disability (RB 6), the refundable sales tax credit (RB 11) and interest on tax refunds and payments (RB 28). Others have not been applied because they do not correspond to features of our tax system. This is the case for the surtax on personal income (RB 9), the child tax credit (RB 10), the reduction in corporate tax rates (RB 20), and the 3% surtax applicable to corporations (RB 21).

* The references in parentheses stand for the number corresponding to the budget resolutions in the federal notice of ways and means motion of February 26, 1986.

Finally, certain measures have not been applied because our tax system does not include corresponding provisions, as is the case for measures concerning the reduction in the investment tax credit (RB 22), modifications to the refundable investment tax credit (RB 23), the elimination of the tax on taxable dividends paid by small corporations (RB 24), and the changes in the withholding tax on interest paid to non-residents (RB 25).

— ***Concordance measures***

Québec's tax legislation and regulations will be amended to incorporate, with adaptations based on their general principles, the federal measures relative to:

1. salary deferral arrangements and unpaid remuneration (RB 1, RB 2 and RB 3);
2. modifications concerning the reduction in the gross-up rate for taxable dividends and the rate of the credit for dividends, subject to specific Québec features (RB 4 in part)[1];
3. tax deductions for trips undertaken for medical purposes or vacations, for residents of the Far North or designated isolated posts (RB 7)[2];
4. tax deductions granted to residents of the Far North and designated isolated posts with respect to housing (RB 8)[2];
5. the exclusion of capital dividends from the calculation of the minimum tax base (RB 12, in part);
6. changes in the rules governing Registered Retirement Income Funds (RB 13);
7. changes in the rules governing maturing Registered Retirement Savings Plans (RB 14);
8. the elimination of the 3% inventory deduction (RB 15);
9. the broadening of current expenditures to include scientific research and experimental development (RB 16);
10. changes in the rules governing flow-through shares (RB 17 and RB 18);
11. changes in the tax rules governing limited partnerships (RB 19);
12. changes in the definition of a corporation carrying on a small business (RB 26);
13. investment income reporting (RB 27);
14. depreciation of wind energy equipment over a three-year period[3];
15. capital cost allowance in regard to certain pipelines costing at least $10 000 000[4];
16. the amendments made in the definition of Canadian exploration costs[5];
17. the capital cost allowance in regard to certain goods acquired as part of contracts entered into with the EXPO 86 Corporation[6].

1 See the detailed note concerning the tax treatment of dividends.

2 See the detailed note on the special deduction for residents of the Far North and designated isolated posts .

3 Budget Papers, Federal Budget, February 26, 1986, p. 46.

4 P.C. 1986-193, SOR/86-156, January 23, 1986.

5 Press release of the federal Minister of Finance, December 31, 1985.

6 P.C. 1984-3995, SOR/85-13, December 17, 1984.

SUMMARY OF THE FINANCIAL IMPACT OF FISCAL MEASURES (in millions of dollars)

	Impact on the tax burden on the private sector		Financial impact on the Québec government		
	1986	1987	1986-1987	1987-1988	1988-1989
1. Improvement in taxation in regard to employees and new corporations'					
☐ Special deduction in regard to shares purchased by employees	(1)	(3)	—	(1)	(3)
☐ Exemption for new corporations	(5)	(16)	(3)	(19)	(28)
☐ **Subtotal**	(6)	(19)	(3)	(20)	(31)
2. Measures concerning revenue					
☐ Surtax on business firms					
— employer contributions to HSF	39	62	82	98	104
— tax on capital	17	27	38	44	48
— corporate income tax	23	36	32	36	39
— **subtotal**	79	125	152	178	191
☐ Standardization of taxation of various forms of energy					
— elimination of certain exemptions	67	100	97	103	106
— compensation measures for low-income taxpayers	—	(24)	(1)	(4)	(19)
— adjustment for aircraft fuel and locomotive fuel oil	1	2	1	2	2
☐ Restrictions on the interest and dividend deduction and on the retirement income deduction	82	84	—	82	84
☐ **Subtotal**	229	287	249	361	364
3. Measures concerning outlying regions[1]					
☐ Reduction in the fuel tax	(4)	(5)	(4)	(5)	(5)
☐ $300 000 exemption for paid-up capital for corporations operating in the fishery sector	—	—	—	—	—
☐ Special deduction for residents of the Far North and designated isolated posts	—	(23)	—	—	(23)
☐ **Subtotal**	(4)	(28)	(4)	(5)	(28)
4. Tax adjustments related to the capitalization of business firms[1]	—	—	—	—	—
5. Miscellaneous measures[1]	(1)	(2)	(2)	(2)	(2)
6. Concordance with federal legislation and regulations					
☐ Tax treatment of dividends	—	44	—	—	44
☐ $500 000 lifetime capital gains exemption	—	(28)	—	—	(28)
☐ Elimination of the deduction for inventories	19	24	11	30	26
☐ Other concordance measures	—	—	—	—	—
☐ **Subtotal**	19	40	11	30	42
TOTAL	**237**	**278**	**251**	**364**	**345**

N.B.: For taxpayers, a number in parentheses indicates a reduction in the tax burden.
1 The effects of the measures concerning expenditures are not included.

APPENDIX B

Medium-term Outlook on the Québec Government's Financial Position

Introduction 3

Medium-term economic outlook 3

Medium-term financial framework 4

Budgetary revenue 5

Budgetary expenditure 6

Financial framework 8
— ***Deficit*** 8
— ***Net financial requirements*** 9

Financial indicators 10

Conclusion 14

Introduction

Any medium-term financial forecast scenario is very sensitive to the economic assumptions underlying it. Despite the restrictions and risks inherent in this type of exercise, drawing up a multi-year financial framework constitutes an indispensable management tool. This exercise is even more important this year, given the government's goal of straightening out Québec's public finances.

In this respect, this three-year forecast exercise enables us to evaluate the medium-term impact, on the financial framework, of the fiscal and budgetary measures adopted in 1986-1987 with a view to closing the budgetary gap. It also enables us to assess what remains to be done to attain the government's objectives.

Medium-term economic outlook

After three years of recovery, the scars left by the last recession are still visible in most industrialized countries. The international economic context continues to be characterized by numerous imbalances which hamper economies' growth potential. Furthermore, rapid structural changes disrupt the competitive position among economies and cause concern in many countries.

Despite the fact that GDP was estimated at $105 000 000 000 in 1985, Québec's economy is relatively small and its industrial structure continues to rely too heavily on traditional industries, which are vulnerable to competition from countries with low manpower costs. The Québec economy is also a very open one; approximately 40% of its production is destined for export markets, principally those of the United States and Ontario. Because of Québec's openness its medium-term economic performance will be determined principally by the stability and vitality of the economic growth anticipated for the United States and the rest of Canada. Moreover, Québec's relative performance will also be influenced by the behavior of consumers and business firms, the government's economic policies, and the particular features characterizing its industrial structure.

The present forecast of medium-term trends in the Québec economy therefore depends on the realization of a number of assumptions chosen from a large range of possibilities. Of the basic assumptions selected, which have a preponderant effect on the results, we should point out the following:

— that real interest rates should remain generally higher than those experienced in the past despite the drop in nominal interest rates. In this context, economic growth among our principal trading partners will continue, but at a moderate pace;

— that it is unlikely that the world price of oil will maintain its present level. It should rise before the end of the year but is expected to remain less than $20 US per barrel until the end of the decade;

— that current rather restrictive monetary and fiscal policies in Canada will be maintained and that the exchange rate of the Canadian dollar will hover around 70 cents US.

Economic growth of 3.0 % to 3.5 % in Canada

On the basis of these assumptions, it is estimated that economic growth in Canada between 1987 and 1989 will vary between 3.0% to 3.5% with inflation fluctuating around 3.5%. In Québec, economic growth over the coming years should continue at a moderate rate reflecting the outlooks for its principal trading partners. The following table gives a summary of the medium-term forecast of the main economic indicators.

MEDIUM-TERM ECONOMIC OUTLOOK IN QUÉBEC

	1975 to 1980	1981 to 1985	1986-1990 Entire period	1986 to 1987	1988-1990
	(Average annual growth rate)				
Gross domestic product	12.1	8.4	6.5	6.0	6.9
Real domestic product	2.5	1.8	3.1	3.0	3.1
Consumer prices	8.6	7.6	3.5	3.1	3.7
Average weekly wage	9.6	6.9	4.3	3.9	4.6
Wages and salaries	11.5	6.9	6.4	5.5	7.0
Retail sales	10.0	8.7	6.0	5.8	6.1
Employment	2.1	0.9	2.3	2.1	2.5
Unemployment rate*	9.9	12.5	10.8	11.4	10.4

* Percentage level

The growth forecast for Québec is based mainly on the anticipated vitality of its exports outside Canada. This forecast pursues the trend of increased penetration of foreign markets, which has characterized some of Québec's industries since the mid-1970s. This development will compensate for a forecast of relatively moderate growth in domestic demand, reflecting the low demographic growth anticipated as well as the unfavorable impact of relatively high real interest rates. Competition of imports from countries with low manpower costs should also remain keen and could result in additional difficulties in certain vulnerable industries in the manufacturing sector.

Although the performance anticipated for Québec is encouraging in the light of the results of the past ten years, it will nonetheless remain insufficient for correcting its principal economic weaknesses. Given external factors, the present forecast, which is based on the continuance of past economic trends, shows that the problems of unemployment and under-investment observed at present will not automatically disappear between now and the end of the decade.

However, adopting a different set of assumptions with regard to external factors could change this conclusion considerably. This is particularly true of interest rates and the world price of oil.

As for internal factors, the Québec government has already made known its desire to eliminate the obstacles to economic growth in Québec. The Budget Speech prepares the ground for certain measures to this end. A positive response from the private sector to actions already taken and to orientations for action in economic matters announced by the government could result in private investment exceeding the anticipated level. The government has also decided to implement all means possible to speed up the sale of electricity to our U.S. neighbours. Accelerating Hydro-Québec investments would contribute directly to restoring the rate of productive investment in the economy.

Medium-term financial framework

Deficit lower than $2 900 000 000 in 1986-1987

The financial framework forecast is based on the economic scenario described above. This forecast shows that the growth of budgetary revenues will probably be higher by almost two percentage points than the growth of budgetary expenditure in 1986-1987, and subsequently, by one percentage point. This change will enable the budgetary deficit to sink to $2 900 000 000 in 1986-1987 and to less than $2 600 000 000 in 1988-1989.

A number of important measures announced when the Estimates were tabled, or stated in this Budget Speech, contribute to reducing the deficit. Given the fact that federal transfers have levelled off, the economic performance anticipated will be insufficient to bring about automatic decreases in the deficit. Anticipated reductions therefore depend on the government's determination to implement appropriate rationalization measures.

Budgetary revenue

CHANGE IN BUDGETARY REVENUES COMPARED WITH GDP[1]
(In millions of dollars)

	1976-1977	1977-1978	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988-1989
Own-source revenue	7 155	8 009	8 566	9 457	10 722	12 910	13 918	15 074	15 946	17 765	19 275	20 480	22 215
% change	16.8%	11.9%	7.0%	10.4%	13.4%	20.4%	7.8%	8.3%	5.8%	11.4%	8.5%	6.3%	8.5%
Federal transfers	2 561	3 136	3 333	3 824	3 972	4 572	5 292	6 337	6 364	6 313	6 310	6 465	6 625
% change	13.6%	22.5%	6.3%	14.7%	3.9%	15.1%	15.7%	19.7%	0.4%	−0.8%	0.0%	2.6%	2.5%
Budgetary revenue	9 716	11 145	11 899	13 277	14 694	17 482	19 210	21 411	22 310	24 078	25 585	26 945	28 840
% change	15.9%	14.7%	6.8%	11.6%	10.7%	19.0%	9.9%	11.5%	4.2%	7.9%	6.3%	5.3%	7.0%
Growth rate of GDP in %*	17.5%	8.4%	11.8%	11.4%	11.6%	13.8%	5.0%	7.6%	8.0%	7.5%	5.9%	6.1%	7.1%

* For the calendar year ending three months before the end of the fiscal year.

1 The forecast for 1986-1987 and subsequent years reflects the changes announced in accounting policies.

Following an 11.4% increase in 1985-1986, the growth rate of own-source revenue will slow down during the forecast period while remaining higher than the growth in GDP. In 1986-1987, the anticipated rise in own-source revenue will be 8.5% compared to 5.9% for GDP.

This rate of increase, which is clearly higher than economic growth, reflects the fact that the government was forced to increase certain taxes and income taxes to straighten out its finances. Moreover, other sums resulting from the privatization of certain government corporations and the raising of fees for certain services must be taken into consideration.

Federal transfers are adjusted for previous years based on revisions of the data used in calculating them. An examination of transfers on an accrual basis makes it possible to charge these adjustments to the appropriate years so that fluctuations which bias the analysis of their changes are partially eliminated. The following table presents the results of federal transfers on both a cash basis and an accrual basis.

CHANGE IN REVENUE FROM FEDERAL TRANSFERS
(in millions of dollars)

	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988-1989
Transfer revenue (cash basis)	6 337	6 364	6 313	6 310	6 465	6 625
% change	19.7	0.4	−0.8	0.0	2.5	2.5
Adjustment for previous years	−310	−152	− 54	+ 14	+ 69	− 6
Transfers attributable to the current year (accrual basis)	6 027	6 212	6 259	6 324	6 534	6 619
% change	12.5	3.1	0.8	1.0	3.3	1.3

Slow growth in federal transfers

An analysis of expected transfers on an accrual basis shows that they will continue to grow slowly over the next few years. In 1986-1987, the 3.6% drop in equalization entitlements will be one of the main factors contributing to the expected slowdown. The impact could be mitigated if the federal government were to agree to reverse its decision and grant Québec the $66 000 000, in accordance with its commitment to guarantee that 1985-1986 equalization revenue will not drop below 95% of the 1984-1985 entitlements for all recipient provinces.

In addition, this forecast assumes that transfers under health and post-secondary education (EPF) will be slashed as announced by the federal government, according to Bill C-96, tabled in the House of Commons last February 14. Should this Bill be adopted, its effect would be to reduce the growth of the federal contribution by two percentage points compared to the previous formula, which was tied to the growth of the economy. The impact of the cutbacks would be to reduce financial transfers by $82 000 000 in 1986-1987. These reductions will rise every year to reach almost $400 000 000 in 1989-1990. Consequently, financial transfers to Québec under the EPF will stop growing and begin to decrease in 1988-1989.

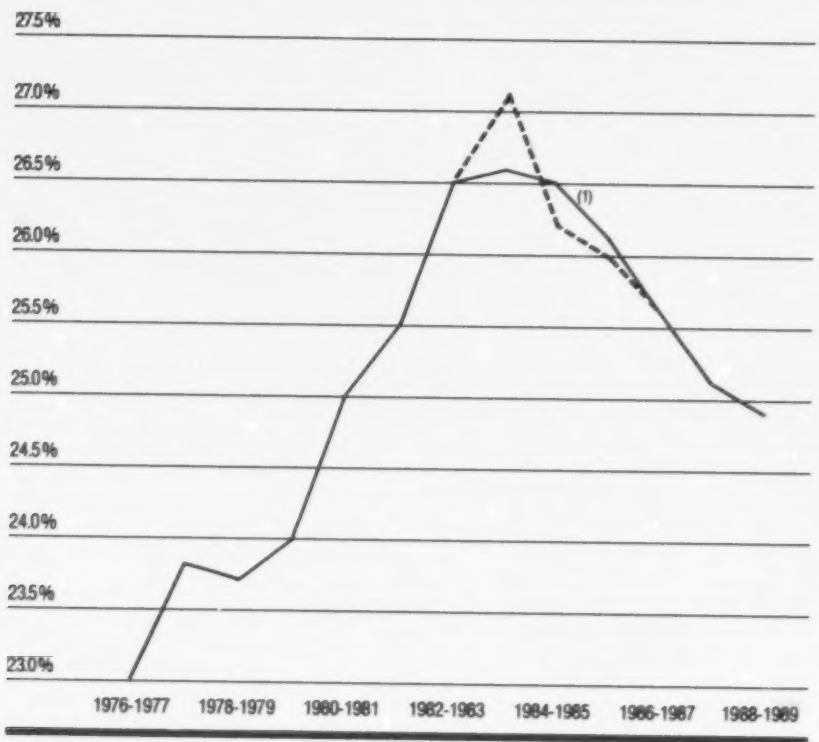
Growth in federal transfers could return to a more reasonable rate if the federal government agreed to withdraw Bill C-96 and begin negotiations aimed at reaching a consensus with respect to the next fiscal arrangements.

Budgetary expenditure

In retrospect, it is clear that the Québec government failed to sufficiently adjust the growth of its expenditures to the structural slowdown in Québec's economy beginning in the mid-1970s. While the government's own-source revenues were more or less keeping pace with the growth of the economy, the decline in the economy was not reflected in expenditure growth rates and a rapid ballooning of the deficit, indebtment and interest costs ensued. The latter rose from $603 000 000 in 1977-1978 to $2 311 000 000 in 1982-1983. Expenditure as a percentage of GDP thus rose from 23% in 1976-1977 to 26.5% in 1982-1983.

A reversal occurred in 1982-1983. However, certain expenditures continue to grow too rapidly, particularly interest, social aid and health insurance costs.

EXPENDITURE AS A PERCENTAGE OF GDP



1 Adjusted total expenditures

COMPARISON OF THE CHANGES IN EXPENDITURE WITH CERTAIN ECONOMIC INDICATORS[1] (in millions of dollars)

	1976-1977	1977-1978	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988-1989
Adjusted total expenditure	10 717	12 045	13 387	15 110	17 582	20 393	22 259	24 093	25 895	27 405	28 447	29 638	31 418
% change	16.1%	12.4%	11.1%	12.9%	16.4%	15.9%	9.2%	8.2%	7.5%	5.8%	3.8%	4.2%	6.0%
Expenditure paid in advance in 1983-1984								431	−422	−5	−5		
Expenditure paid in advance in 1984-1985									70	−70			
Expenditure carried forward										−100	38	12	12
Total expenditure according to the Public Accounts	10 717	12 045	13 387	15 110	17 582	20 393	22 259	24 524	25 543	27 230	28 480	29 650	31 430
% change	16.1%	12.4%	11.1%	12.9%	16.4%	15.9%	9.2%	10.2%	4.2%	6.6%	4.6%	4.1%	6.0%
GDP growth rate in %*	17.5%	8.4%	11.8%	11.4%	11.6%	13.8%	5.0%	7.6%	8.0%	7.5%	5.9%	6.1%	7.1%
Canadian inflation rate in %*	7.5%	8.0%	8.9%	9.2%	10.2%	12.5%	10.8%	5.8%	4.4%	4.0%	3.0%	2.9%	3.9%

* For the calendar year ending three months before the end of the fiscal year.

1 The forecast for 1986-1987 and subsequent years reflects the changes announced in accounting policies.

The forecast shows that budgetary expenditure will continue its moderate growth to the end of the forecast period. The financial framework has been adjusted to take revisions to the economic parameters into consideration and updated to reflect the results of the program review, which led to preparing the appropriations for 1986-1987, on the following: salaries and other remuneration in the public service and the education and social affairs networks, the government contribution to public sector retirement plans, the debt service and debt service subsidies, social aid, health insurance and health assistance expenditures.

Cuts of $806 000 000

Other factors affect the medium-term forecast for expenditure, namely the impact of measures announced by the Chairman of the Conseil du trésor in tabling the Estimates for fiscal 1986-1987 as well as changes to expenditures introduced in the Budget Speech. For fiscal 1986-1987, the Chairman of the Conseil du trésor has announced cutbacks and reductions in the estimates amounting to $1 010 000 000. However, he has had to provide for an amount of $204 000 000 to cover additional developments. All in all, re-examining expenditures has therefore permitted reducing them by $806 000 000.

Furthermore, this Budget introduces further cuts of $400 000 000 on an annual basis beginning in January 1987, which will clearly have repercussions in 1988-1989. As yet, no cuts have been forecast for 1988-1989. As in 1986-1987, management of expenditure will free $175 000 000 in net lapsed appropriations in coming years.

Expenditures for 1987-1988 will therefore not exceed $29 650 000 000, a growth rate of 4.1%. The level of expenditure anticipated for fiscal 1988-1989 is $31 430 000 000, an increase of 6%.

With this expenditure control policy, the level of expenditures in the GDP will have dropped from a peak of over 26.6% in 1983-1984 to less than 25% in 1988-1989.

Financial framework

— *Deficit*

The financial framework forecast indicates that the deficit will settle at $2 895 000 000 in 1986-1987 and fall to $2 705 000 000 in 1987-1988 and $2 590 000 000 in 1988-1989.

SUMMARY OF FINANCIAL TRANSACTIONS[1, 2]
(in billions of dollars)

	Budgetary transactions			Balance of non-budgetary transactions	Net financial requirements
	Revenue	Expenditure	Deficit		
1976-1977	+ 9.7	−10.7	− 1.0	− 0.3	− 1.3
1977-1978	+11.1	−12.0	− 0.9	− 0.3	− 1.2
1978-1979	+11.9	−13.4	− 1.5	+ 0.2	− 1.3
1979-1980	+13.3	−15.1	− 1.8	+ 0.5	− 1.4
1980-1981	+14.7	−17.6	− 2.9	+ 0.6	− 2.3
1981-1982	+17.5	−20.4	− 2.9	+ 0.8	− 2.1
1982-1983	+19.2	−22.3	− 3.0	+ 0.8	− 2.2
1983-1984	+21.4	−24.5	− 3.1	+ 0.9	− 2.2
1984-1985	+22.3	−25.5	− 3.2	+ 1.2	− 2.0
1985-1986	+24.1	−27.2	− 3.2	+ 1.5	− 1.7
1986-1987	+25.6	−28.5	− 2.9	+ 1.2	− 1.7
1987-1988	+26.9	−29.6	− 2.7	+ 1.0	− 1.7
1988-1989	+28.8	−31.4	− 2.6	+ 1.0	− 1.6

N.B.: A (−) sign indicates a financing requirement and a (+) sign, a source of financing.
1 Data have been rounded off
2 The forecast for 1986-1987 and subsequent years reflects the changes announced in accounting policies.

It should be noted that the reduction in the deficit in 1986-1987 and 1987-1988 is essentially due to remedial measures adopted over these two years. Since no corrective measures have been planned for fiscal 1988-1989, it would be possible to reduce the deficit forecast at the end of the forecast period still more. More favorable economic performance would also have the same impact.

— Net financial requirements

Over the coming years, non-budgetary transactions will continue to give rise to large surpluses. The retirement plans account will generate increasingly larger surpluses rising from $1 266 500 000 in 1985-1986 to $1 665 000 000 in 1988-1989.

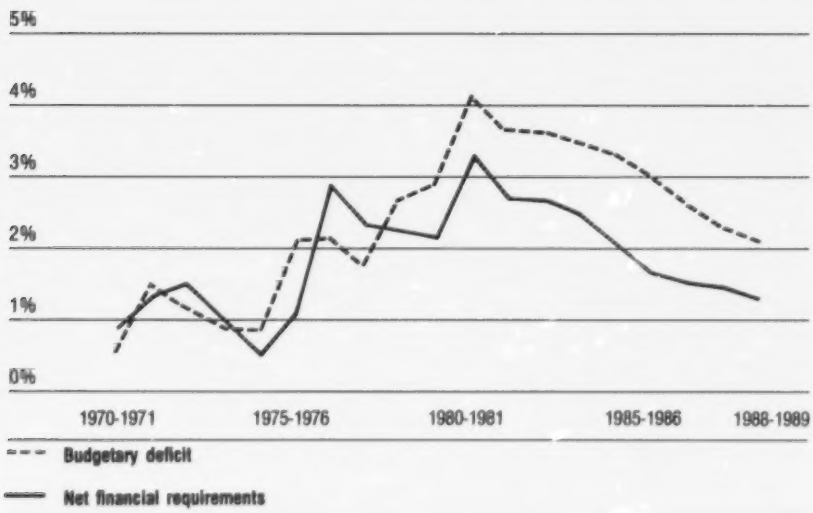
The category of investments, loans and advances, an important source of funds in 1986-1987, reflecting the anticipated results of privatizing certain government corporations, will subsequently give rise to increased financial requirements. This development can be attributed to the re-evaluation of government investments in its fully-owned corporations by recording their profits and net losses as a counterpart entry to budgetary revenues, following modification of their accounting treatment.

The evolution of other non-budgetary accounts shows a somewhat greater increase, in the medium term, of government receivables compared to its accounts and accrued interest payable. For 1986-1987, the anticipated settlement of accounts payable recorded at the end of fiscal 1985-1986 to reflect the wage offers tabled for public sector employees and to carry accounts payable not previously recorded over to liabilities, will, following the change in accounting procedures, result in a requirement for $300 000 000 in funds.

Financial Indicators

The implementation of fiscal and budgetary measures to reduce the deficit will result in a great improvement in indicators of the government's financial position. Budgetary deficit and net financial requirements as a percentage of GDP will continue to drop, settling in 1988-1989 at the mid-1970s level.

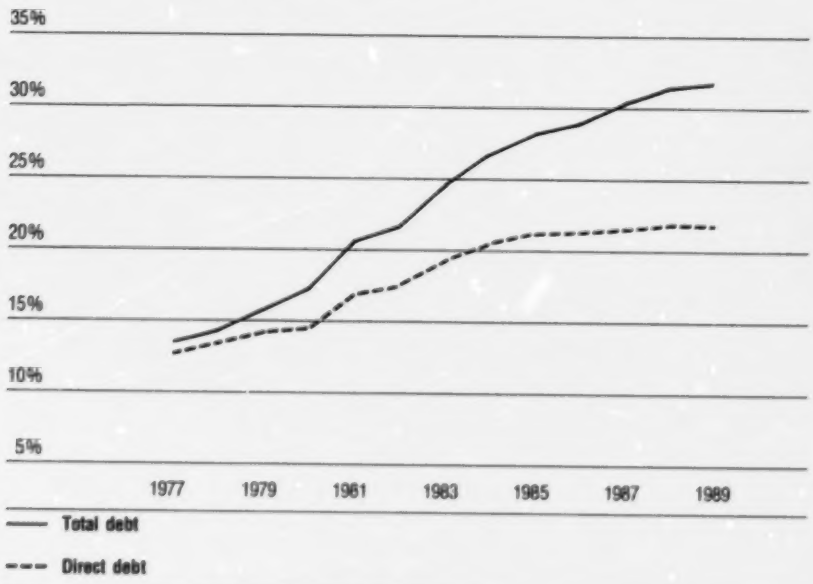
BUDGETARY DEFICIT AND NET FINANCIAL REQUIREMENT IN PROPORTION TO GROSS DOMESTIC PRODUCT



A gradual decrease in the deficit will also entail, for the first time since 1970, a reduction in the government's direct debt as a percentage of economic activity. After having peaked at 21.8% in 1987-1988, the direct debt as a percentage of to GDP will drop to 21.7% in 1988-1989.

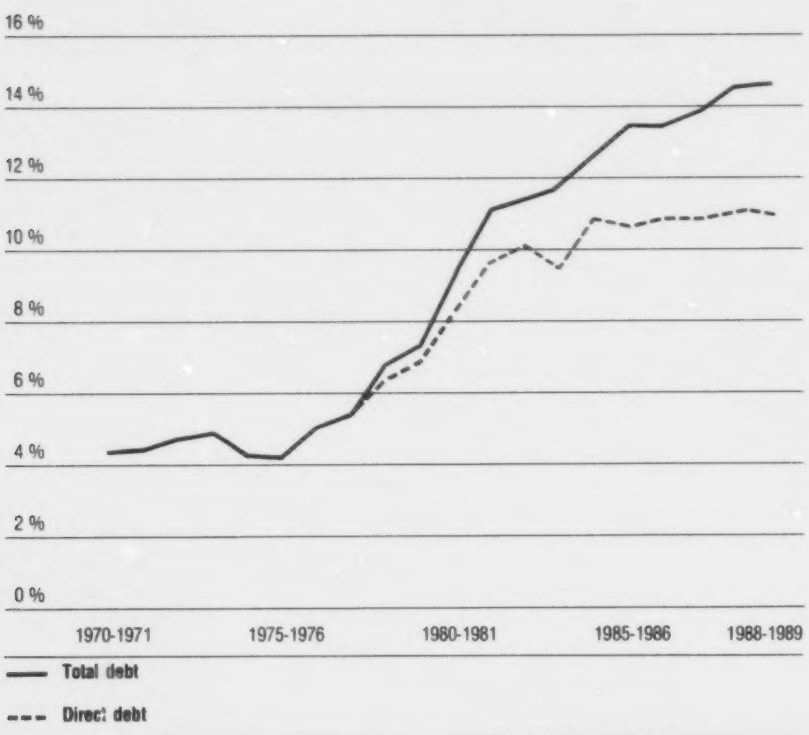
Furthermore, the rise in the government's total debt, which includes the direct debt and the provision of the public and parapublic retirement plans, compared to Québec's economic growth will slow down considerably over the coming years. After having increased at annual rates sometimes reaching 2 percentage points in past years, the total debt as a percentage of GDP will increase only 0.5 percentage points in 1988-1989 rising from 31.1 % to 31.6 %. For it to remain at 31.1 % in 1988-1989, it would have been necessary to reduce the deficit to $2 000 000 000.

DEBT AS AT MARCH 31 IN POURCENTAGE OF GROSS DOMESTIC PRODUCT



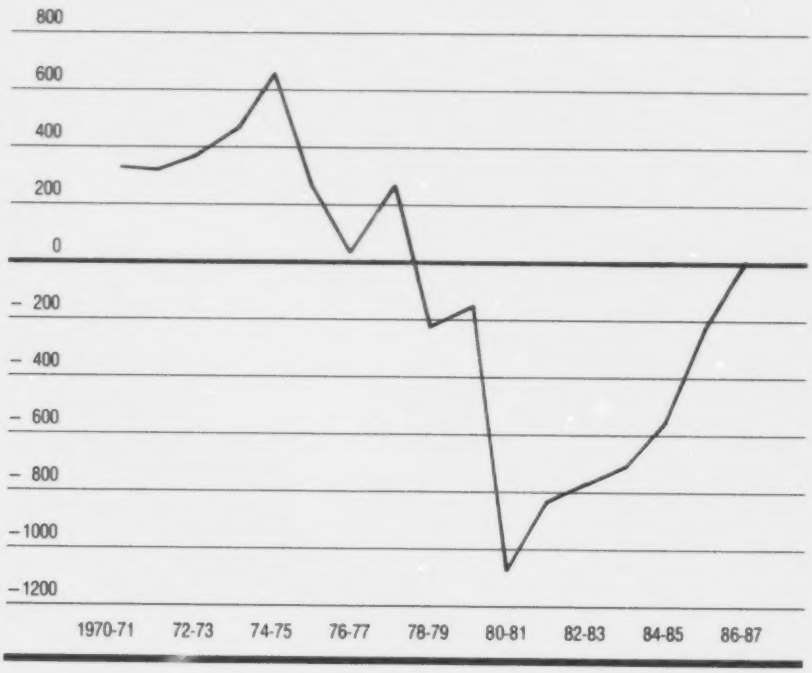
As shown in the following graph, stabilizing the debt as a percentage of GDP has positive consequences for the progression of costs for servicing the debt. Although the growth of interest costs has continued to reduce the government's room to manoeuvre over the past ten years, a net decrease in this phenomenon can now be observed. This stems, in part, from the slower increase in the debt compared with economic growth and, in part, from the reduction of interest rates.

INTEREST COSTS AS PERCENTAGE OF BUDGETARY REVENUE



The impact of the corrective measures implemented by the government is also highlighted by the change in the current account balance, which corresponds to the budgetary deficit calculated by excluding the government's direct and indirect capital expenditures and its contributions to public and parapublic sector retirement plans. In 1986-1987, the current account will be balanced for the first time since 1977-1978; there was a deficit of more than $1 000 000 000 in 1980-1981. With the reduction in the deficit anticipated in this forecast, we could expect the current account balance to show surpluses once again.

CURRENT ACCOUNT BALANCE
(in millions of dollars)



Conclusion

The three-year financial framework forecast clearly shows that the process of straightening out public finances is well under way; the budget deficit is gradually being reduced and there is a return to a balance in the current account. In addition, as of 1988-1989, the direct debt will begin to increase less quickly than the capacity to pay, as measured by GDP.

However, the forecast also shows that balance will not be entirely achieved by the end of the forecast period. The total debt continues to increase more quickly than the capacity to pay, so that interest costs are still a constraint in managing the financial framework.

Own-source revenue is growing at a rate higher than expected in the economy and it would be unreasonable to call for more rapid growth by increasing the tax burden since such an increase would undermine the competitive character of Québec's taxation system. The slow growth of federal transfers is one of the most decisive factors standing in the way of a more complete balance. Over the coming three years, federal transfers are forecast to increase, on the average, at a rate of close to 5 percentage points less than that of the GDP. Given the measures anticipated, budgetary expenditure would increase at a rate approximately 1.5 percentage points less than that of the GDP.

Unless the economy shows a better performance than expected, a more complete balance of Québec's public finances could result only from greater flexibility in the federal position with regard to transfers to the provinces, or from further corrective measures. The role of the federal government will therefore be decisive in developments in Québec's public finances over the coming years.

APPENDIX C

Changes in Accounting Policies

Introduction 3

Treatment of retirement plans liabilities 3

Treatment of unrecorded accounts payable 4

Treatment of investments in government entreprises 5

Treatment of the allowance for bad debts and bad debts written off 5

Treatment of the translation of the long-term debt in foreign currencies 6

Impact of the changes 7

Introduction

In his report on the government's 1984-1985 financial statements released last December, the Auditor-General issued restrictions in regard to current accounting policies. Although he considers that the presentation of financial information is proper and consistent, in accordance with the government's accounting policies, nonetheless, the Auditor-General is of the opinion that some of these policies are not appropriate to a fair and full presentation of its accounts.

In previous reports, the Auditor-General had also expressed certain reserves concerning the same elements of government accounting practices, namely:

- ☐ the treatment of retirement plan liabilities;
- ☐ the treatment of unrecorded accounts payable;
- ☐ the treatment of investments in government enterprises; and
- ☐ the treatment of the allowance for bad debts and bad debts written off.

Over the past few months, the government has not only studied the Auditor-General's comments, but has also examined all its accounting practices in order to introduce appropriate changes. In so doing, it has taken into account, both with respect to accounting and actuarial considerations, questions related to current practice as well as recommendations of regulatory bodies, and has adapted them in a manner consistent with the environment of government accounting.

Changes mindful of the comments of the Auditor-General and the practices followed by other governments in the country

Given a context in which comprehensive "generally accepted standards" have yet to be agreed on with respect to government accounting and in which there is little uniformity in the accounting methods used by various governments in Canada, the Québec government intends to take the Auditor-General's opinion into account, while doing what it can to provide financial information on a basis comparable to that used by other governments in the country.

In addition, the government has decided to introduce changes, as of fiscal 1986-1987, in regard to three of the four elements concerning which the Auditor-General expressed restrictions in his report for 1984-1985. It has also been concluded, following this examination, that the accounting policy concerning the treatment of the translation of the long-term debt in foreign currencies is inappropriate, and will thus be amended at the same time. Once the changes described in the following pages have been implemented, the accounting policies followed by the Québec government will compare favourably, on the whole, with those in effect elsewhere. As a result, the government's financial position will be presented with greater strictness, using a more appropriate approach.

Treatment of retirement plans liabilities

The Auditor-General is of the opinion that, even though the government includes a note to its financial statements displaying sufficient information as to its overall liabilities with respect to the retirement plans, only a portion of its liabilities in this regard are accounted for in the financial statements, whereas it should actually enter the entire amount as a liability.

In this regard, the government's examination has revealed numerous and, in certain cases, significant differences in the methods used by various governments in Canada to estimate and account for their pension plan liabilities.

As determined by actuarial valuations, these liabilities may change significantly depending on the economic assumptions used in the actuarial calculations, and depending on the methods of the actuarial calculations themselves. The results are very sensitive to the assumptions used and to different calculation methods. In light of the government's examination, it appears that, on the whole, the Québec government is rather rigorous in this regard, compared to the situation prevailing elsewhere.

A task force on the retirement plans liabilities

The government has also decided to maintain, for the time being, the treatment used up till now for retirement plan liabilities, and to continue disclosing all relevant information in a note to the financial statements. A task force made up of government officials and specialists from the accounting and actuarial professions will be given the mandate to conduct a wide-ranging examination of the methods used to estimate and account for the retirement plans liabilities, compared with those in use elsewhere, and to recommend appropriate changes where needed.

Treatment of unrecorded accounts payable

The Auditor-General recommends that changes be made in the accounting methods so that all expenditures incurred by the government during a fiscal year are recorded in the books at year-end. This refers both to the government's direct expenditures and to accrued transfer expenditures, related to operating costs actually incurred by establishments or institutions of the education, health and social service networks.

Under current accounting policies, expenditures are accounted for on an accrual basis, with the exception of retirement plans contributions, which are governed by a specific provision. April 30 is the cut-off date for setting up an account payable in relation to the fiscal year ended March 31, if it covers services provided or goods received prior to April 1.

However, the terms of application in force up till now provide that only charges incurred against an authorized appropriation are to be entered as expenditures. A note to the financial statements indicates the expenditures which could not be charged against an appropriation. This practice will be changed as of fiscal 1986-1987 so that the government's expenditures will be recorded on an accrual basis, in accordance with the provisions of the accounting policy, with a 30-day period at the end of a fiscal year for creating an account payable with respect to transactions of the year just ended.

Expenditures recorded on the basis of amounts actually due

This change in accounting practices will, for all practical purposes, separate the notions of expenditures and appropriations. In accordance with the Financial Administration Act (R.S.Q., chap. A-6), the latter will always be required for any payment of public monies from the Consolidated Revenue Fund. However, expenditures will, from now on, be recorded on the basis of amounts actually due, even if they should exceed available appropriations. The required appropriations will then be obtained through legislative authorization.

The government's direct expenditures will thus be recorded in the accounts for the same fiscal year in which they are incurred. With respect to transfers to establishments of the networks for costs they incur, the government's share of such costs will be carried to budgetary expenditures according to the actual rate at which services are provided. In this way, without affecting the rate of disbursements, the delay in allocating to expenditures the cost of services supplied, in relation to the time at which the services are provided within the networks, will be eliminated.

Once the data for accounts payable not entered in the books as at March 31, 1986, have been finalized, they will be carried to the government's liabilities as at the same date, with a corresponding adjustment to the net debt. A bill will be tabled in the National Assembly in order to make this adjustment official and to authorize the appropriations needed to cover these accounts payable in subsequent fiscal years.

Treatment of investments in government enterprises

The existing accounting policy provides that the government's investments in its enterprises are entered in its financial statements at cost. The Auditor-General is of the opinion that this policy should be changed so that prolonged reductions in the value of investments in certain enterprises, resulting from significant accumulated losses over the years and their inability to meet their obligations, are reflected as a reduction of their book value. The amount by which the accumulated deficits of these enterprises exceeds the cost of the investment would then be reflected by entering an allowance for losses under expenditures.

When investments are shown in the accounts at cost, adjustments cannot be made to the government's financial position when, on the whole, its enterprises incur losses. In addition, profits earned and accumulated by these enterprises, which may be considerable, cannot be reflected in the accounts. The existing accounting policy must therefore be modified to take all of these elements into account and provide a more complete picture of the government's financial position.

The government's investments in shares recorded on an equity basis

It therefore appears more appropriate, beginning in fiscal 1986-1987, to account for the government's investments in capital stock in its enterprises on an equity basis, for commercial and other enterprises, except for those of a fiduciary nature or insurance funds. By annually adjusting the book value of the government's investments to reflect profits and losses recorded by its enterprises, and by incorporating these in the results of its own operations, the new method will enable the government to provide a more exact picture of its situation in this regard. When the accumulated deficit of an enterprise exceeds the cost of the government's investment therein, an allowance for losses on investments will be set up and entered as an expenditure. At the same time, this accounting change will be an important step in moving towards greater completeness in the government's financial statements. This objective was also mentioned in the Auditor-General's recommendations.

Once the figures from the financial statements of the enterprises involved have been compiled for the fiscal year ending in the government's 1985-1986 fiscal year, the value of the government's investments in these enterprises will be adjusted as of March 31, 1986, based on the amounts of the reserves and accumulated deficits of each one. A corresponding entry for this adjustment will then be carried to the government's net debt.

Treatment of the allowance for bad debts and bad debts written off

Since the government takes its own-source revenue into its accounts on an accrual basis, generally accepted accounting principles require that an annual analysis of accounts receivable be undertaken in order to estimate the amounts where collectibility is considered doubtful. This estimate, the "allowance for bad debts", provides a means of entering accounts receivable in the statement of assets and liabilities at their estimated realizable value. The same practice is used for the government's loans and advances, except for those granted to its own enterprises.

In accrual basis accounting, since revenues are matched to expenditures, the provision must be charged to expenditures of the current fiscal year as debts are recognized as being irrecoverable. This corresponds to the accounting policy followed by the Québec government until fiscal 1979-1980.

Beginning in fiscal 1980-1981, this practice was altered so that the annual change in the allowance for bad debts was carried directly to the net debt rather than to expenditures. In this way, only those bad debts which were written off during a fiscal year were entered as expenditures.

The provision for bad debts recorded in accordance with current principles

The Auditor-General is of the opinion that this is not an appropriate accounting treatment, and, in particular, it has had the effect of understating expenditures and the government's budgetary deficit over the past few years. In fact, the accounting policy currently used postpones the posting of bad debts to expenditures until future years, since write-offs are generally made many years after the allowance has been set up. The appropriateness of the Auditor-General's restriction in regard to this irregular accounting policy, which does not agree with generally accepted principles, should be recognized, particularly as the Québec government is alone in applying a treatment that differs from current principles.

The accounting policy in regard to bad debts will therefore be changed once again as of fiscal 1986-1987. Henceforth, the accounting treatment will be the same as prevailed prior to 1980-1981. The annual change in the allowance for bad debts will be carried to expenditures rather than being directly entered in the net debt, while subsequent write-offs of bad debts will be deducted from the allowance rather than entered as expenditures.

Treatment of the translation of the long-term debt in foreign currencies

An accounting policy taking into account variations in foreign currencies

Currently, the applicable accounting policy provides that long-term borrowings in foreign currencies are to be entered in the books at the Canadian equivalent of their face value when they are contracted. The difference between the amount repaid and the amount received on foreign currency borrowings is thus carried to the operating results only when the loan is repaid. A note to the annual financial statements indicates the difference in the Canadian equivalent of the face value of these borrowings between the time they were contracted and the end of the current fiscal year. This practice was current at a time when international borrowings were less significant and exchange rates relatively more stable.

Since 1983, the accounting profession has amended its standards in this regard so that there is no undue carry-over to future fiscal years of expenditures with a high probability of being incurred and which are materialized over time. Accounting organizations now recommend that long-term debt in foreign currencies be converted to their domestic currency equivalent at the end of each fiscal year, using current rates of exchange, and that the difference with the amounts actually received when they were contracted be amortized over the remaining term of such debts.

Beginning in fiscal 1986-1987, the government will amend its method of accounting for foreign currency long-term borrowings in accordance with these recommendations. The accumulated difference observed on March 31, 1986, between the Canadian equivalent calculated using current exchange rates on the outstanding debt at such date and the amounts received when these borrowings were contracted will be charged to the government's books using an equivalent adjustment to the public debt and the net debt.

Impact of the changes

Changes without impact on net financial requirements

The changes in accounting practices introduced with this budget will have a considerable impact on the results of budgetary transactions and on the government's non-budgetary accounts. However, as they will have no effect on the rate at which receipts and disbursements are effected, they will have no impact on net financial requirements, since their effects on budgetary transactions and non-budgetary transactions will offset each other.

The adjustments to the government's statement of assets and liabilities as of March 31, 1986, reflecting the changes in the treatment of unrecorded accounts payable of the government's investments in the capital stock of its enterprises, and of the translation of the long-term debt in foreign currency, will bring about an increase of $1 223 000 000 in the net debt, based on preliminary data currently available. The net value of the government's investments in its enterprises will rise by $1 309 000 000, the difference due to foreign currency will add $1 343 000 000 to the net debt on the books, while an amount estimated at $1 189 000 000, which could not have been recorded under the former accounting policies, will be carried to accounts payable.

To provide a clearer picture of the impact of the change in the treatment of bad debts, the following table presents data relative to the period from fiscal 1980-1981 to 1985-1986, adjusted to reflect the new accounting policy, beginning in 1986-1987.

IMPACT OF THE CHANGE IN THE ACCOUNTING TREATMENT OF BAD DEBTS ON HISTORICAL FIGURES
(in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
Budgetary transactions						
Budgetary revenue	+14 694.0	+17 481.7	+19 210.3	+21 410.9	+22 310.0	+24 078.0
Budgetary expenditures before change	−17 592.0	−20 393.4	−22 259.3	−24 523.5	−25 542.5	−27 230.0
☐ incorporation of the annual change in the allowance for bad debts	− 115.3	− 79.5	− 109.3	− 61.2	− 122.4	− 78.0(E)
Budgetary expenditures after change	−17 707.3	−20 472.9	−22 368.6	−24 584.7	−25 664.9	−27 308.0
Budgetary deficit — before change	− 2 898.0	− 2 911.7	− 3 049.0	− 3 112.6	− 3 232.5	− 3 152.0
— after change	− 3 013.3	− 2 991.2	− 3 158.3	− 3 173.8	− 3 354.9	− 3 230.0
Non-budgetary transactions						
Balance of non-budgetary transactions before change	+ 585.3	+ 765.4	+ 812.7	+ 891.8	+ 1 230.5	+ 1 455.1
☐ incorporation of the annual change in the allowance for bad debts	+ 115.3	+ 79.5	+ 109.3	+ 61.2	+ 122.4	+ 78.0(E)
Balance of non-budgetary transactions after change	+ 700.6	+ 844.9	+ 922.0	+ 953.0	+ 1 352.9	+ 1 533.1
Net financial requirements	**− 2 312.7**	**− 2 146.3**	**− 2 236.3**	**− 2 220.8**	**− 2 002.0**	**− 1 696.9**

(E) Estimate
N.B.: A (−) sign indicates a financial requirement and the (+) sign, a source of financing.

The following table compares the evolution of the government's financial transactions over the past few years. It presents the actual results for 1984-1985 and the preliminary results for 1985-1986, adjusted on the basis of the accounting policies used to establish the 1986-1987 budgetary forecasts.

STATEMENT OF FINANCIAL TRANSACTIONS REFLECTING CHANGES IN ACCOUNTING POLICIES (in millions of dollars)

	1984-1985	Preliminary results 1985-1986	Budgetary forecasts 1986-1987
Budgetary transactions			
Revenue	+22 310.0	+24 096.3	+25 585.0
Expenditure	−26 336.3	−27 507.0	−28 480.0
Deficit	− 4 026.3	− 3 410.7	− 2 895.0
Balance of non-budgetary transactions	+ 2 024.3	+ 1 713.8	+ 1 215.0
Net financial requirement	− 2 002.0	− 1 696.9	− 1 680.0

N.B.: A (−) sign indicates a financial requirement and a (+) sign a source of financing.

APPENDIX D

Review of the Economic Situation in 1985 and Outlook

The economic situation in 1985 3

Canada 4

Québec 7
— Consumer income and spending 8
— Private and public investment 9
— Non-residential investment 9
— International exports 11

Outlook for 1986 11

— External environment 11
— Review of outlook in Québec 12

Economic indicators — Canada 14

Economic indicators — Québec 14

Economic growth continues in Québec and throughout Canada

In 1985, the economic situation continued to improve in Québec and elsewhere in Canada. Output and employment grew more rapidly than expected a year ago, while inflation, interest rates and the unemployment rate continued to fall. Preliminary data for Québec indicate that real domestic product increased by 4.0%, compared with 4.3% in Canada as a whole.

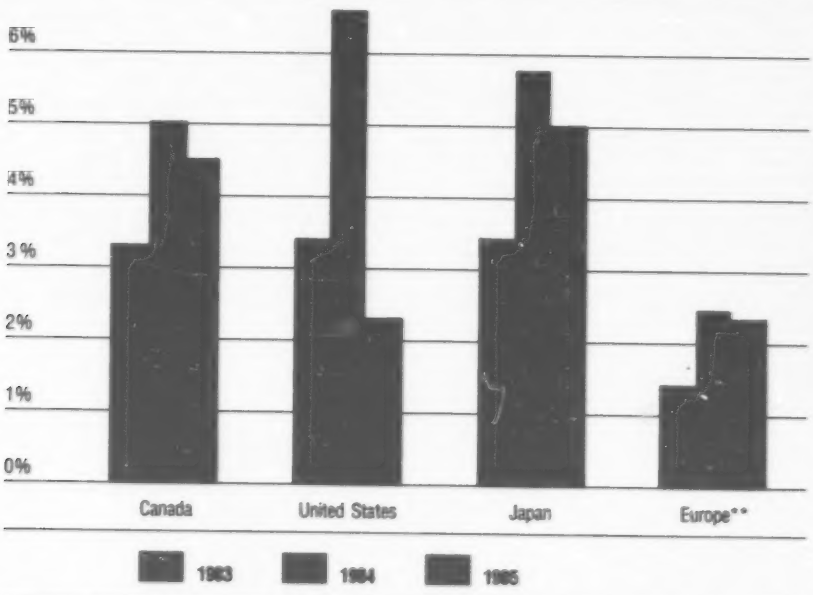
This year, the fourth in the current economic expansion cycle which began at the end of 1982, should see further improvement in economic conditions in Québec and Canada, although growth in output should be lower than last year. It is anticipated that real domestic product will increase by about 3.0% in 1986.

The Economic Situation in 1985

According to the OECD, growth in member countries reached 2¾ %

In 1985, the main industrialized countries achieved further growth and reduced imbalances thanks to lower interest rates and inflation. Growth in the volume of output in OECD countries reached 2¾ % in 1985, lower than the preceding year. This slowdown is primarily attributable to changes noted in the United States, where growth stabilized at lower levels, similar to the ones recorded in other OECD countries. At the same time, inflation continued to decline in the industrialized nations overall, falling to its lowest level since the end of the 1960s. These factors, combined with relatively modest growth in ongoing economic expansion and certain achievements in reducing the U.S. budget deficit, made possible a realignment of the principal currencies in relation to the U.S. dollar and a general reduction in interest rates.

GROSS NATIONAL PRODUCT* OF SELECTED OECD COUNTRIES
(annual percentage change)



* In volume.

** Four major countries, i.e., Germany, France, United Kingdom, Italy.

Sources: OECD Economic Outlook, December 1985, Data Resources Inc., Review of the U.S. Economy, March 1986, Statistics Canada.

APPENDIX D

Canada

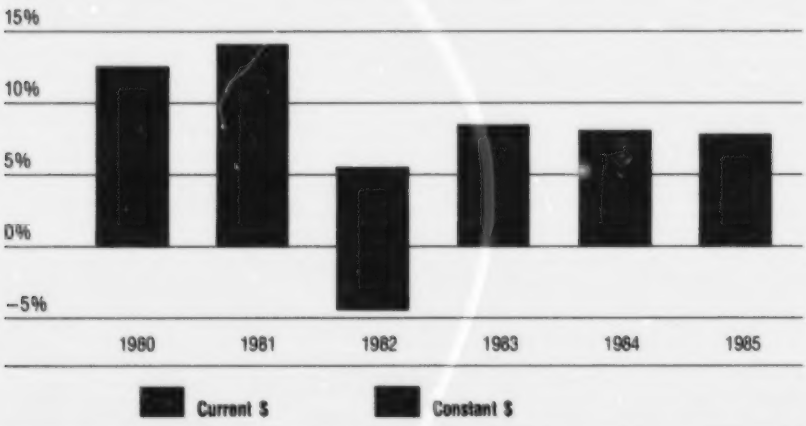
Canada's real GNP grew by 4.5 %

Contrary to 1983 and 1984, domestic demand was the key element in rising output in Canada last year. Gross national product increased by 4.5% by comparison with 5.0% the preceding year, despite a marked downturn in the growth of exports. At the same time, employment increased by 2.8% and the unemployment rate decreased again, from 11.3% in 1984 to 10.5% in 1985.

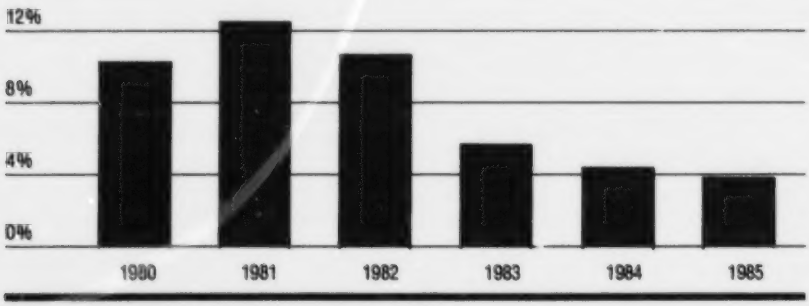
Inflation reached 4.0 %

In Canada, as in other industrialized countries, inflationary pressures continued to abate. The rate of increase in consumer prices declined, from 4.4% in 1984 to 4.0% in 1985, despite further depreciation of the Canadian dollar in relation to the currencies of its principal trading partners. Moderate increases in negotiated wages, low prices for raw materials and additional increases in productivity are the main factors contributing to this change.

GROSS NATIONAL PRODUCT — CANADA
(annual percentage change)



CONSUMER PRICE INDEX
(annual percentage change)

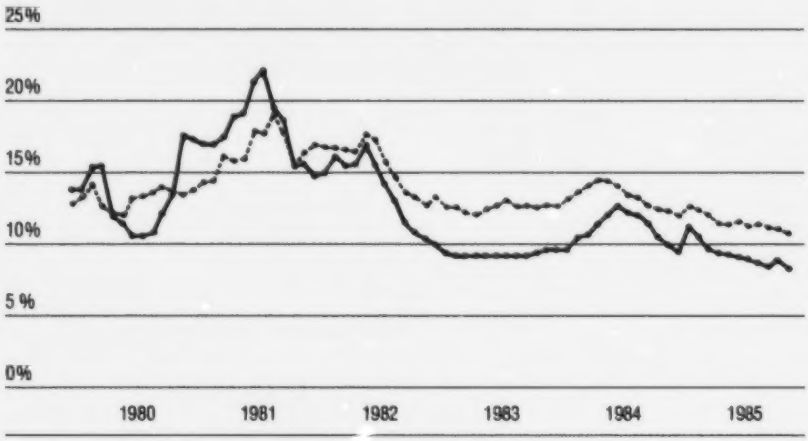


Sources: National Income and Expenditure Accounts, S.C., 13-001.
The Consumer Price Index, S.C., 62-001.

Interest rates fell

Further reductions in interest rates throughout North America were one of the most encouraging aspects of Canada's economic situation in 1985. Short and long-term interest rates dropped in Canada, in a manner similar to trends noted in the United States, despite downward pressure experienced by the Canadian dollar during the year. Interest rates decreased by an average of between 150 and 175 basis points; toward the end of the year, they reached their lowest levels since the end of the 1970s.

SHORT AND LONG-TERM INTEREST RATES — CANADA



Sources: Bank of Canada.
Ministère des Finances du Québec.

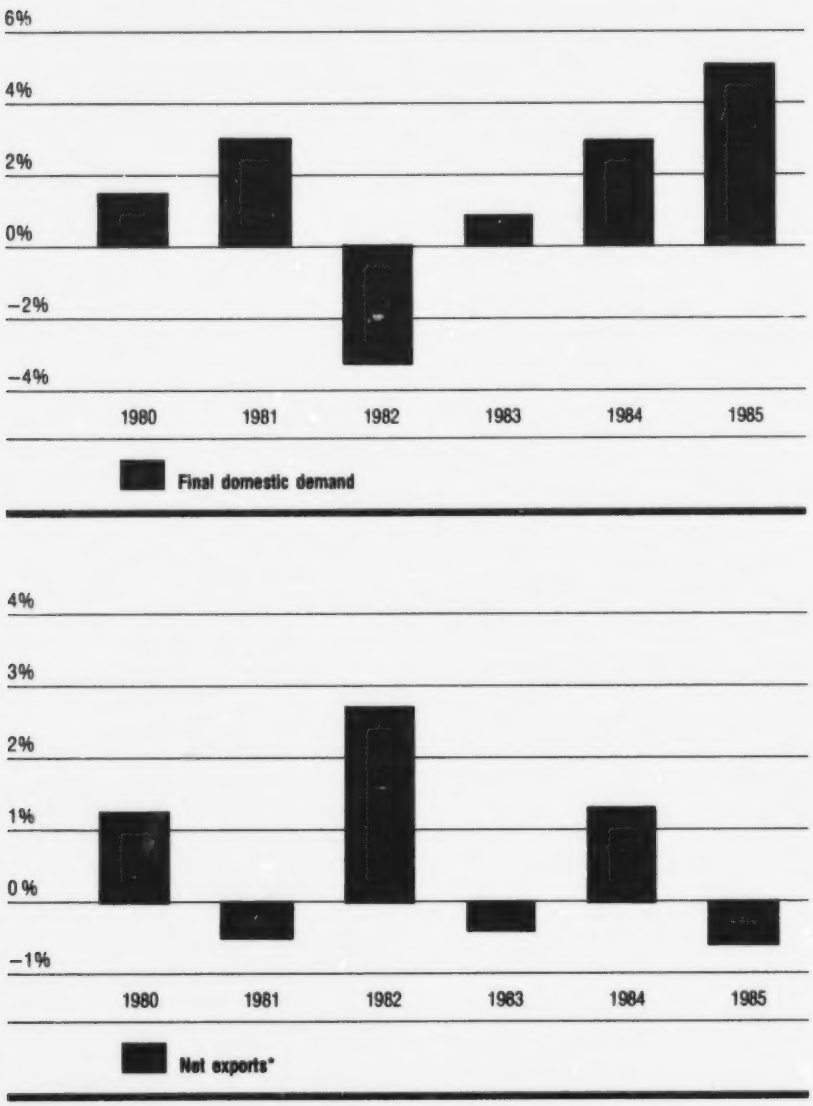
Domestic demand increased markedly

The upturn in domestic demand, which accelerated from 2.9% in 1984 to 5.0% in 1985, was distributed among the principal categories of expenditure, with the exception of government spending. The volume of personal expenditure on goods and services underwent its most rapid growth since 1976, and increased more quickly than household disposable income. Purchases of durable goods were particularly brisk, as was the case during the previous two years. Moreover, increased consumer spending was much more generalized than in 1984; demand for semidurable goods, food and services increased faster than to the preceding year.

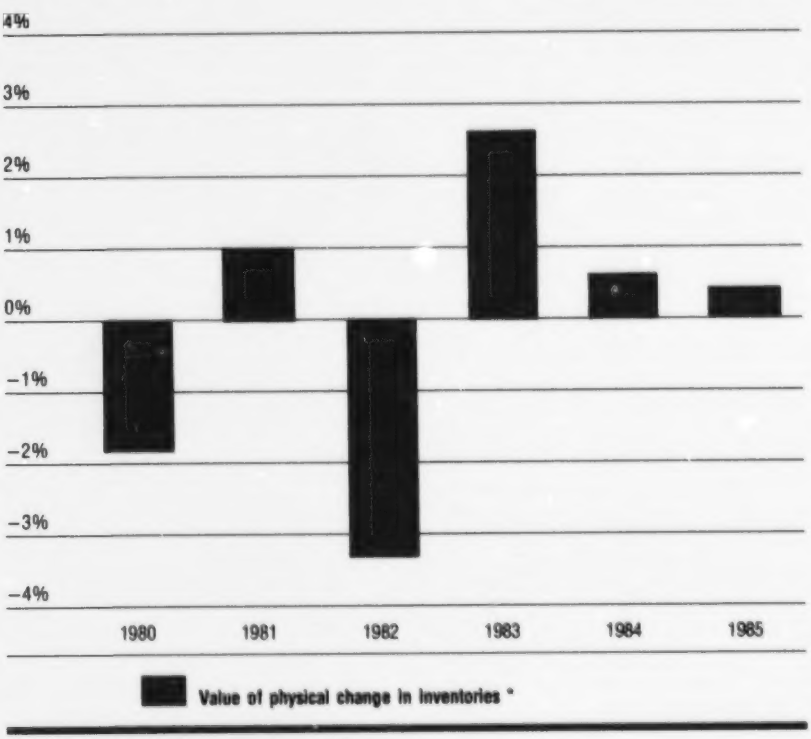
However, growth in investment, whether in the residential or the non-residential sector, was the outstanding component of growth in demand last year. With regard to the housing sector, improvement in the financial position of households and the drop in interest rates resulted in an 18.2% increase in residential construction. The rise in new housing construction resulted from the growth in housing starts which increased from 134 900 to 165 826, while the resale market also experienced very marked growth.

Non-residential investment grew significantly for the first time since 1981, by 5.1%, after declining by 20.4% between 1981 and 1984. Capital expenditures by companies were especially brisk in the manufacturing, finance and commercial services sectors. Moreover, the Western Accord between the federal government and the oil and natural gas producing provinces also resulted in an upturn in capital expenditures in the mining sector.

SOURCES OF GROWTH — CANADA
(annual percentage change)



SOURCES OF GROWTH — CANADA
(annual percentage change)



* Net contribution to growth as a percentage of GNP.
Source: National Income and Expenditure Accounts, S.C., 13-001.

Québec

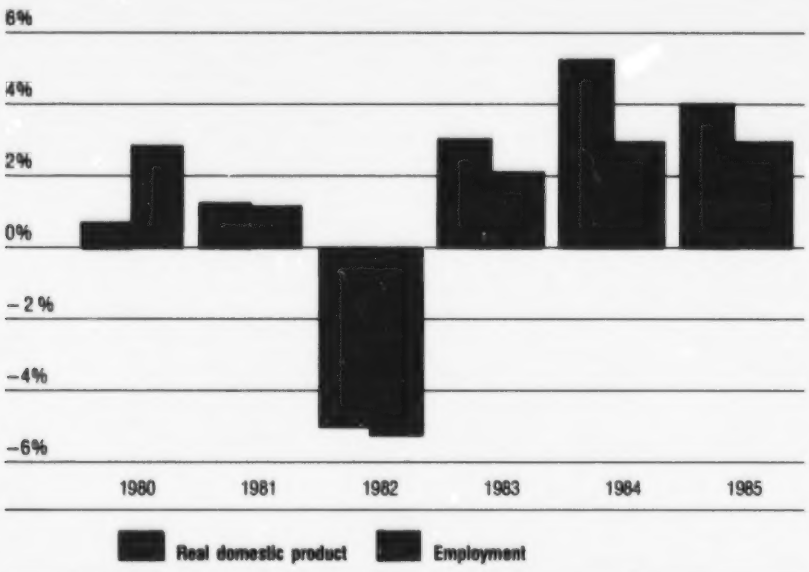
Québec's GDP reached nearly $105 000 000 000

In Québec, output continued to grow in 1985, although at a slower pace than the preceding year. The volume of real domestic output increased by 4.0% compared with 5.2% in 1984. Contrary to what had been noted in Canada as a whole, the rate of increase in Québec domestic demand lagged in relation to the preceding year. This development applied to personal expenditure on goods and services, and capital expenditures. A number of industrial sectors were affected by this situation. Nonetheless, growth was sustained in the public utilities, construction, commerce and finance sectors. Taking into account inflation, it is estimated that gross domestic product increased in value by 7.5%, reaching nearly $105 000 000 000.

Unemployment rate reached 11.8 %

Despite declining growth in output, employment increased at a rate similar to that observed the preceding year, i.e., 3.0%, which represents the creation of 82 000 jobs, of which 49 000 were full time and 32 000 part time. On a sectorial basis, the increase in employment was concentrated in service industries, while goods-producing industries lost 6 000 jobs, because of a decrease of 12 000 jobs in the manufacturing sector. Given increases in the working age population and participation rates, the labour force grew by 1.9%, with the result that the growth in employment reduced the unemployment rate, which fell from 12.8% in 1984 to 11.8% in 1985.

REAL DOMESTIC PRODUCT AND EMPLOYMENT — QUÉBEC
(annual percentage change)



Sources: Conference Board of Canada.
The Labour Force, S.C., 71-001.

— *Consumer income and spending*

Personal disposable income grew by 7.1 %

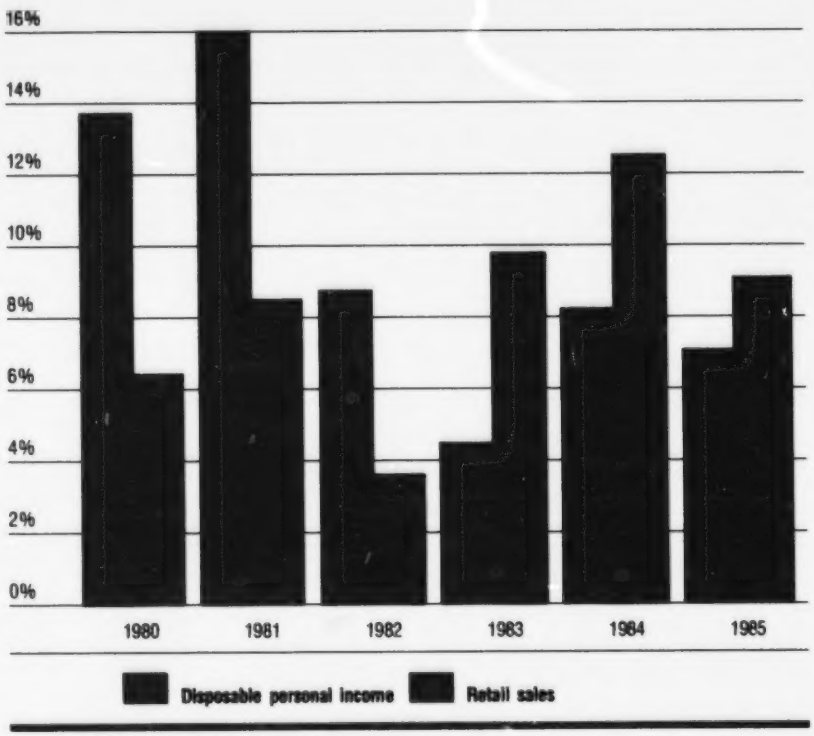
Personal income increased by 7.8 % last year, slightly less than the preceding year. Growth in personal income was sustained by growth in wages and salaries, non-agricultural individual businesses and investment income. However, the disposable personal income of households increased less rapidly than personal income, i.e., by 7.1 % because of increases in transfers to governments.

As was the case in Canada overall, sustained economic growth, improved conditions on the labour market and the reduction in interest rates and inflation helped maintain consumer confidence at a high level. Households reduced their rate of saving, with the result that personal spending for goods and services increased more quickly than disposable income, although at a lower rate than the preceding year.

Retail sales increased by 9.1 %

Consequently, retail sales increased by 9.1 % in 1985, compared with 12.5 % in 1984. In Canada as a whole, growth reached 10.6 % in 1985. As in 1984, retail automobile sales increased the most rapidly, by 21.5 %. Over the past three years, such sales have doubled. Sales have largely outstripped the rate of inflation in furniture and appliance as well as clothing and shoe stores.

DISPOSABLE PERSONAL INCOME AND RETAIL SALES — QUÉBEC
(annual percentage change)



Sources: Ministère des Finances du Québec
Provincial Economic Accounts, S.C., 13-213.
Retail Trade, S.C., 63-005.

— *Private and public investment*

Private and public investment increased by 7.8%

In 1985, private and public investment increased by 7.8% in Québec, totalling $16 979 600 000. After increasing for two years more rapidly than in Canada, the growth in capital expenditures in Québec was below that in the country overall, where it reached 8.9%. The slowdown noted in Québec reflects a reduction in growth in the non-residential and housing construction sectors. In particular, growth in investment in the housing sector fell from 13.4% to 10.7%, despite an upturn in housing starts, from 41 902 in 1984 to 48 031 in 1985.

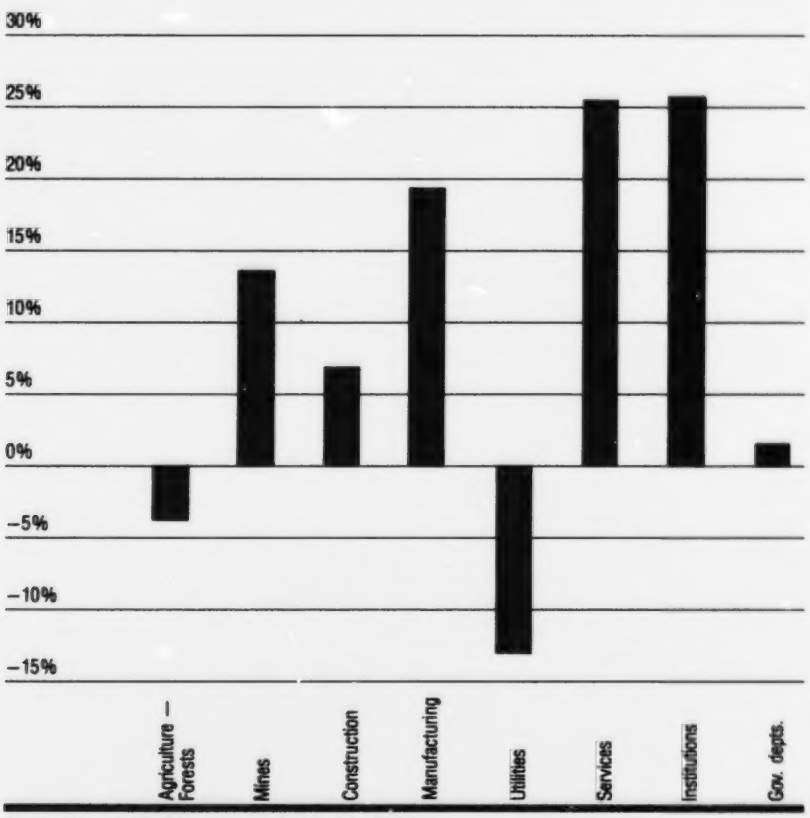
— *Non-residential investment*

Non-residential investment rose by 7.0%

After increasing by 12.9% in 1984, non-residential investment only increased by 7.0% last year. Although decelerating, private-sector investment continued to grow rapidly in 1985, by 16.4%. On the other hand, public-sector capital expenditures again fell, by 5.7%, because of marked downturns in investment made by commercial government corporations.

As the following graph indicates, growth in non-residential investment was unevenly distributed among various industries. Sharp increases were noted in services, institutions and manufacturing, partially offset by reductions in public utility services and stabilization of capital expenditures by government departments. Moreover, various projects launched in 1984 under the impetus of government grants in the mining sector continued, and resulted in a marked increase in capital expenditures in this industry last year.

NON-RESIDENTIAL INVESTMENT — QUÉBEC, 1985
(annual percentage change)



Source: Private and Public Investment in Canada, S.C., 61-205.

In the manufacturing sector, the 19.3% increase in capital expenditures was also largely concentrated in sectors where such expenditures were made in response to governmental financial incentives, i.e., pulp and paper (44.4%) and primary metals (29.1%), especially aluminum. In 1985, both industries accounted for more than three-quarters of overall growth in investment in the manufacturing sector. Growth in capital expenditures in service industries was especially pronounced in the finance (45.4%) and commercial services (25.5%) sectors.

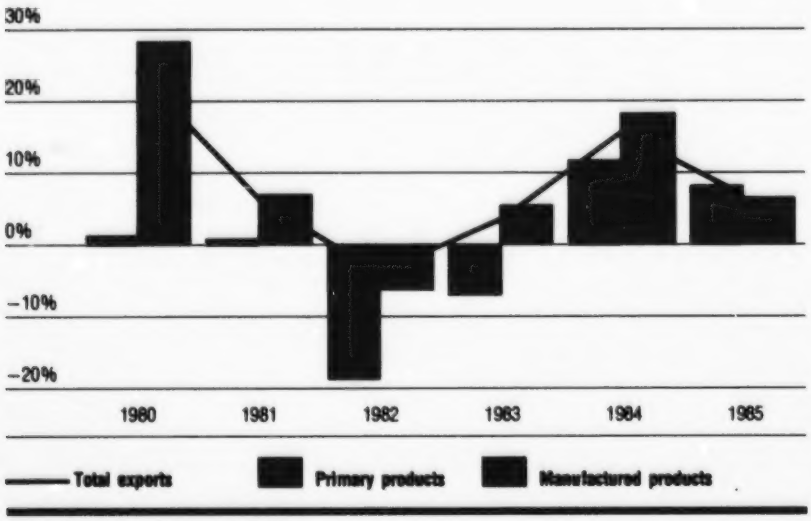
— *International exports*

A weakening in demand in the U.S. led to a reduction in the growth of exports

The weakening in U.S. demand resulted in a deceleration in international exports loaded in Québec, which only increased by 7.2% in 1985, compared with 16.0% the previous year. Reduced growth in exports was particularly pronounced for manufactured products which, except for motor vehicles and automobile parts, did not increase in volume, after a sharp upturn in 1984.

The upswing in shipments abroad of motor vehicles and automobile parts, from 7.0% in 1984 to 32.8% last year, was more than offset by a steep reduction in the growth of other categories of manufactured products, especially machinery and equipment, construction materials and intermediate products and supplies. Pulp and paper exports stagnated, after increasing by 22.7% in 1984, while shipments of metallic products fell by 6.2%, because of 17.4% and 3.6% decreases in copper and aluminum shipments, respectively.

INTERNATIONAL EXPORTS LOADED IN QUÉBEC
(annual percentage change)



Source: Bureau de la Statistique du Québec.

Outlook for 1986

In 1986, the Québec economy will continue to grow, as is the case in Canada overall, although less rapidly than last year. Growth in output and employment will occur in a context characterized by low inflation and falling interest rates.

— *External environment*

Because Québec is open to external markets, its economic performance is strongly influenced by that of its principal trading partners, i.e., the United States and the other provinces of Canada.

The North American economy will continue to grow in 1986.

In the United States, the major analysts anticipate that economic growth will continue at a moderate rate, as noted in 1985. Housing construction should be brisk, in response to the anticipated reduction in interest rates, while the depreciation of the U.S. dollar on international markets will foster increased exports. Inflationary pressures will continue to abate as the effects of the drop in the value of the U.S. dollar will be obviated by moderation in wage increases and, above all, by the drop in the price of crude oil.

The drop in the price of oil now constitutes a decisive element for the outlook for short-term economic growth, inflation and interest rates in the industrialized economies. In preparing the economic outlook for the 1986-1987 budget, the hypothesis of an average price of $15 US per barrel in 1986 was employed. A further reduction in the price of oil would certainly have a beneficial effect on the economy. However, it must be emphasized that marked fluctuations in the price of oil in recent months have, according to a number of specialists, brought it to a level considerably below that which would prevail were the principal producers to reach an agreement. Under these circumstances, forecasting the average price of oil for the entire year is a particularly risky venture.

In Canada, these developments on the oil market will adversely affect the oil and natural gas producing provinces. However, the decline in capital expenditures in the oil and gas industry should be offset by positive spinoff in other sectors of the Canadian economy. In constant dollars, gross national product will increase by about 3.0% in 1986; inflation will reach a similar figure.

Economic growth will be sustained, in the first instance, by consumer demand and, to a lesser extent, by demand from business outside the oil industry. Interest rates should continue to fall significantly throughout the year. The latter forecast is predicated on the assumption that the Canadian dollar will remain fairly stable on exchange markets, resulting in a return to much lower spreads between interest rates in Canada and the United States.

— Review of outlook in Québec

Output is expected to increase by 3.2% in Québec in 1986. Gross domestic product will increase by 5.9%, reaching $111 000 000 000. As is the case elsewhere in Canada, household consumption will be the driving force behind growth; at the same time, the rate of personal saving is expected to decrease further, which will result in a significant increase in the volume of consumption. This increase will be reflected in additional growth of about 6.8% in retail sales in the province.

In Québec, output will increase by 3.2%.

With regard to housing construction, housing starts will total an estimated 46 000 units. This high level of activity, in the absence of government grants, reflects the combined effect of confidence displayed by Québec households in the economy and the anticipated drop in interest rates.

After the cyclical upswing which followed slow growth at the beginning of the 1980s, non-residential investments are expected to taper off in 1986. This slowdown of the rate of increase will, moreover, be accentuated by the high level of investment in 1985 attributable to subsidy programs covering mining and manufacturing investment.

Employment will continue to rise and unemployment to decline

On the labour market, growth in employment will continue to surpass that in the labour force this year, thereby causing an additional reduction in the unemployment rate. In light of changes in demand and output, the increase in employment should be better distributed than in 1985 among various industrial sectors. In particular, employment in the manufacturing sector will record a sufficient increase to offset last year's losses.

SUMMARY OF OUTLOOK FOR QUÉBEC

	1985	1986
	%	%
Output		
☐ Gross domestic product	7.5	5.9
☐ Real domestic product	4.0	3.2
Components of demand		
☐ Non-residential investment	7.0	2.8
☐ Housing starts[1]	48 031	46 000
☐ Retail sales	9.1	6.8
Components of income		
☐ Wages and salaries	6.4	5.6
☐ Personal income	7.8	5.9
☐ Corporate profits	3.3	2.2
Labour market		
☐ Labour force	1.9	1.8
☐ Employment	3.0	2.2
☐ Unemployment rate	11.8	11.4

1 Units

ECONOMIC INDICATORS
CANADA

	Unit of measurement	1981	1982	1983	1984	1985[1]	81-80	82-81	83-82	84-83	85-84	85-81[2]
							%	%	%	%	%	%
Gross national product	$000 000	339 797	358 302	389 844	420 870	453 724	14.2	5.4	8.8	8.0	7.8	7.5
Real domestic product	$000 000 $71	121 071	115 891	118 977	124 861	130 254	2.8	−4.3	2.7	4.9	4.3	1.8
Per capita real domestic product	$71	4 974	4 705	4 781	4 970	5 136	1.5	−5.4	1.6	3.9	3.3	0.8
Personal income	$000 000	288 529	317 426	336 984	362 086	392 406	17.9	10.0	6.2	7.4	8.4	8.0
Per capita personal income	$	11 853	12 887	13 542	14 412	15 474	16.5	8.7	5.1	6.4	7.4	6.9
Total capital expenditures	$000 000	79 604	76 761	73 519	75 378	82 091	20.3	−3.6	−4.2	2.5	8.9	0.8
— manufacturing sector	$000 000	12 739	11 493	8 858	8 887	11 004	30.7	−9.8	−22.9	0.3	23.8	−3.6
Value of shipments — manufacturing industries	$000 000	190 851	187 409	201 974	226 841	242 986	13.4	−1.8	7.8	12.3	7.1	6.2
Retail sales	$000 000	94 293	97 638	106 243	116 080	128 427	12.2	3.5	8.8	9.3	10.6	8.0
Consumer Price Index	1981 = 100	100.0	110.8	117.2	122.3	127.2	12.5	10.8	5.8	4.4	4.0	6.2
Population (June 1)	'000	24 342	24 632	24 885	25 124	25 359	1.2	1.2	1.0	1.0	0.9	1.0
Labour Force	'000	11 904	11 958	12 183	12 399	12 639	2.9	0.5	1.9	1.8	1.9	1.5
Employment	'000	11 006	10 644	10 734	11 000	11 311	2.8	−3.3	0.8	2.5	2.8	0.7
Unemployment rate	%	7.5	11.0	11.9	11.3	10.5						

1 Preliminary data.

2 Annual compound rate.

Sources: National Income and Expenditure Accounts, S.C., 13-001, Gross Domestic Product by Industry, S.C., 61-005, Private and Public Investment in Canada, S.C., 61-205, Inventories, Shipments and Orders in Manufacturing Industries, S.C., 31-001, Retail Trade, S.C., 63-005, The Consumer Price Index, S.C., 62-001, Estimates of Population for Canada and the Provinces, S.C., 91-201, The Labour Force, S.C., 71-001.

ECONOMIC INDICATORS
QUÉBEC

	Unit of measurement	1981	1982	1983	1984	1985[1]	81-80	82-81	83-82	84-83	85-84	85-81[2]
							%	%	%	%	%	%
Gross domestic product	$ 000 000	80 015	84 009	90 432	97 631	104 905	13.8	5.0	7.6	8.0	7.5	7.0
Real domestic product	$ 000 000 $71	27 549	26 178	26 995	28 411	29 538	1.4	−5.0	3.1	5.2	4.0	1.8
Per capita real domestic product	$71	4 279	4 040	4 147	4 343	4 489	0.6	−5.6	2.6	4.7	3.3	1.2
Personal income	$ 000 000	71 383	77 761	81 641	88 218	95 096	16.6	8.9	5.0	8.1	7.8	7.4
Per capita personal income	$	11 087	12 001	12 541	13 486	14 451	15.7	8.2	4.5	7.5	7.2	6.8
Total capital expenditures	$ 000 000	13 739	13 097	13 947	15 748	16 980	7.2	−4.7	6.5	12.9	7.8	5.4
— manufacturing sector	$ 000 000	2 272	2 160	2 088	2 751	3 282	3.8	−5.0	−3.3	31.8	19.3	9.6
Value of shipments manufacturing industries	$ 000 000	50 268	48 762	52 049	56 737	59 559	11.9	−3.0	6.7	9.0	5.0	4.3
Retail sales	$ 000 000	22 671	23 497	25 784	29 006	31 637	8.5	3.6	9.7	12.5	9.1	8.7
Consumer Price Index	1981 = 100	100.0	111.6	117.8	122.7	128.1	12.4	11.5	5.6	4.2	4.4	6.4
Population (June 1)	'000	6 438	6 480	6 510	6 542	6 581	0.8	0.6	0.5	0.5	0.6	0.5
Labour force	'000	3 040	2 998	3 069	3 123	3 181	1.7	−1.4	2.4	1.8	1.9	1.1
Employment	'000	2 726	2 584	2 642	2 722	2 804	1.2	−5.2	2.2	3.0	3.0	0.7
Unemployment rate	%	10.3	13.8	13.9	12.8	11.8						

1 Preliminary data.

2 Annual compound rate

Sources: Provincial Economic Accounts, S.C. 13-213, Conference Board of Canada, National Income and Expenditure Accounts, S.C. 13-001, Private and Public Investment in Canada, S.C. 61-205, Inventories, Shipments and Orders in Manufacturing Industries, S.C. 31-001, Retail Trade, S.C. 63-005, The Consumer Price Index, S.C. 62-001, Estimates of Population for Canada and the Provinces, S.C. 91-201, The Labour Force, S.C. 71-001.

APPENDIX E

The Government's Financial Position and Borrowings in the Public Sector

The government's financial transactions 3

- ☐ Budgetary revenue 4
- ☐ Budgetary expenditure 6
- ☐ Non-budgetary transactions 8
- ☐ Repayments of borrowings 9

Financing 10

The debt 13

Public sector borrowings and investments 13

List of tables

Gouvernement du Québec
Statements of financial transactions

- ☐ Summary 19
- ☐ Budgetary revenue 20
- ☐ Budgetary expenditure 21
- ☐ Non-budgetary transactions 22

List of borrowings by the gouvernement du Québec in 1985-1986 24

List of borrowings by Hydro-Québec in 1985 25

Analysis of the government's financial transactions is based on the data determined according to accounting policies in effect for the 1985-1986 fiscal year. The data given in the historical tables have, for the purposes of comparison, been adjusted on the basis of the budgetary and financial structure to prevail in 1986-1987.

The government's financial transactions

Net financial requirements down

Preliminary results of the government's financial transactions for the fiscal year ending March 31, 1986, show net financial requirements of $1 696 900 000 compared to $2 002 000 000 for 1984-1985. Compared to the Budgetary and Financial Policy Statement of last December, these results represent a decrease of $18 100 000 in net financial requirements resulting from an increase of $7 000 000 in the budgetary deficit and a rise of $25 100 000 in the surplus of non-budgetary transactions.

In the Budget Speech of April 23, 1985, net financial requirements were forecast at $1 600 000 000. The Budgetary and Financial Policy Statement presented by the Minister of Finance on December 18, 1985, updated the government's financial position for the first months of 1985-1986 as well as introducing certain budgetary and financial measures resulting notably in the appreciable reduction of the respective increases of $140 000 000 and $185 000 000 in the deficit and the net financial requirements anticipated at the time the Quarterly Presentation of Financial Transactions was released on September 30, 1985.

Deficit: $ 3 152 000 000

The deficit in budgetary transactions has now settled at $3 152 000 000, an increase of $7 000 000 compared to the Budgetary and Financial Policy Statement of last December. This change results from a $23 000 000 increase in revenues combined with a $30 000 000 increase in expenditures.

The surplus in non-budgetary transactions, forecast at $1 430 000 000 last December, rose to $1 455 100 000. A positive variation in the balance of other non-budgetary accounts and a source of financing greater than had been anticipated from investments, loans and advances have more than offset the decrease in the surplus of the retirement plans account.

Borrowings: $ 2 992 600 000

With respect to financing, the combined effect of increased repayments of borrowings and the drop in net financial requirements since the Budgetary and Financial Policy Statement of last December led to a $13 600 000 increase in the government's cash position for 1985-1986, since the new borrowings totalled $2 992 600 000.

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
SUMMARY
(in millions of dollars)

	1984-1985	1985-1986		
		Budget Speech 1985-04-23	Budgetary and Financial Policy Statement 1985-12-18	Preliminary Results[1]
1. Budgetary transactions				
Revenue	+22 310.0	+24 155.0	+24 055.0	+24 078.0
Expenditure	−25 542.5	−27 250.0	−27 200.0	−27 230.0
Deficit	−3 232.5	−3 095.0	−3 145.0	−3 152.0
2. Non-budgetary transactions				
Investments, loans and advances	− 171.8	+ 120.0	+ 150.0	+ 168.2
Retirement plans account	+ 1 183.5	+ 1 335.0	+ 1 300.0	+ 1 266.5
Other accounts	+ 218.8	+ 40.0	− 20.0	+ 20.4
Balance	+1 230.5	+1 495.0	+1 430.0	+1 455.1
3. Net financial requirements	−2 002.0	−1 600.0	−1 715.0	−1 696.9
4. Financing				
Change in cash position	− 211.0	—	− 70.0	− 13.6
New borrowings	+ 3 281.0	+ 3 140.0	+ 2 990.0	+ 2 992.6
Less: Repayments of borrowings	− 1 068.0	− 1 540.0	− 1 205.0	− 1 282.1
Total	**+2 002.0**	**+1 600.0**	**+1 715.0**	**+1 696.9**

Note: A (−) sign indicates a financial requirement and a (+) sign, a source of financing. For the change in cash position, a (−) sign indicates an increase and a (+) sign, a decrease.

1 The 1985-1986 financial data shown in this table are based on results recorded from April 1985 to March 1986 and an estimate as at April 23, 1986 of revenue and expenditure posted during April 1986 on transactions of the lapsed fiscal year, according to accounting policies in effect.

Budgetary revenue

Budgetary revenue: $24 078 000 000

For the 1985-1986 fiscal year, budgetary revenue totalled $24 078 000 000, a 7.9% increase compared to a 4.2% increase for the preceding year. Own-source revenue increased by 11.4% while federal government transfers dropped by 0.8%. Compared to the forecasts in the Budgetary and Financial Policy Statement of December 18, 1985, own-source revenue increased by $165 000 000 whereas federal transfers decreased by $142 000 000.

SUMMARY OF THE EVOLUTION OF OWN-SOURCE REVENUE

	1984-1985	1985-1986			
		Budgetary and Financial Policy Statement 1985-12-18	Preliminary results	Changes compared to Statement	Changes compared to 1984-1985
		(in millions of dollars)			(%)
Personal income tax	7 126.9	7 864.0	7 980.0	116.0	12.0
Employer contributions to the health services fund	1 509.5	1 641.0	1 604.0	− 37.0	6.3
Sales of goods and services	226.5	187.0	215.0	28.0	− 5.1
SOQUIA	−	−	37.0	37.0	−
Other	7 083.6	7 908.0	7 929.0	21.0	11.9
Total own-source revenue	**15 946.5**	**17 600.0**	**17 765.0**	**165.0**	**11.4**

The $116 000 000 increase in personal income tax can be attributed to a level of refunds lower than that anticipated last December and to the increase in deductions at source since that time. The decrease in employer contributions to the health services fund has nevertheless offset this last element.

Moreover, additional revenue of $30 000 000 has been recorded under sales of goods and services as a recovery from the Régie de l'assurance automobile du Québec of the costs of health services related to automobile accidents.

Finally, a $37 000 000 dividend from SOQUIA, which had not been anticipated, resulted from the recent disposal of Provigo Inc. shares held by this government corporation.

SUMMARY OF THE EVOLUTION OF TRANSFERS FROM THE GOVERNMENT OF CANADA

	1984-1985	1985-1986			
		Budgetary and Financial Policy Statement 1985-12-18	Preliminary results	Changes compared to Statement	Changes compared to 1984-1985
		(in millions of dollars)			(%)
Equalization	3 101.6	2 920.0	2 854.0	– 66.0	– 8.0
Other transfers related to the fiscal arrangements	1 833.4	1 974.0	1 942.0	– 32.0	5.9
Contributions to welfare programs	1 147.8	1 226.0	1 198.0	– 28.0	4.4
Other programs	280.7	335.0	319.0	– 16.0	13.6
Total Government of Canada transfers	**6 363.5**	**6 455.0**	**6 313.0**	**–142.0**	**– 0.8**

Close to half of the downward revision in federal government transfers results from the decrease in equalization payments. Federal contributions to health and post-secondary education financing and the welfare programs were also down significantly compared to the forecasts of December 1985.

Equalization payments down

Equalization payments have settled at $2 854 000 000, or $66 000 000 less than what was forecast in the Budgetary and Financial Policy Statement of last December. They were determined using the federal estimate of December 1985. This decrease reflects the Canadian government's refusal to provide Québec with equalization payments for 1985-1986 which are not less than 95% of the entitlements for the preceding year. In effect, based on the federal estimates, the payments received equal only 92.8% of the 1984-1985 entitlements whereas these payments exceed 95% in all other provinces.

The $32 000 000 downward revision in the other transfers linked to the fiscal arrangements originates from payments which are lower than those foreseen for the established programs financing (health and post-secondary education). This results basically from the fact that, in the calculation of the financial transfer related to this program, the federal government used federal tax basis points which are higher than those used in the forecasts of the Budgetary and Financial Policy Statement.

The negative differential of $28 000 000 for welfare programs is due to expenditures which were lower than anticipated, since there was a slight decrease in the clientele and since its composition was altered, to the federal government's refusal to share certain expenses and to a revision of the basic

federal tax which increases the abatement applicable to Québec, reducing the transfer related to this category by the same amount.

Budgetary expenditure

Budgetary expenditure estimated at $27 230 000 000

Preliminary figures indicate budgetary expenditures of $27 230 000 000 for the 1985-1986 fiscal year, an increase of 6.6% compared to 4.2% the previous year. By adjusting the data to allow for expenditures, which were charged in advance, and of those which were carried over to later years, the annual growth rates on a comparable basis stand at 5.8% for 1985-1986 and 7.5% for 1984-1985.

SUMMARY OF THE EVOLUTION OF EXPENDITURE
(in million of dollars)

			1985-1986
	Budgetary and Financial Policy Statement 1985-12-18	Preliminary results	Changes
Initial estimates	27 400.0	27 400.0	—
Plus:			
☐ Supplementary estimates of June 18, 1985	49.5	49.5	—
☐ Supplementary estimates of December 19, 1985	232.5*	228.7	– 3.8
☐ Special warrant of November 20, 1985	0.7	0.7	—
☐ Special warrant of December 4, 1985	0.1	0.1	—
☐ Special warrant of February 19, 1986		58.0	58.0
☐ Supplementary estimates authorized under specific legislative provisions	7.3	13.2	5.9
☐ Overexpenditure on statutory appropriations		103.0	103.0
Less:			
☐ Transfers of budget appropriations to investments, loans and advances	– 5.6	– 8.8	– 3.2
☐ Lapsed appropriations	–484.5	–614.4	–129.9
Total 1985-1986 expenditure	27 200.0	27 230.0	30.0
Total 1984-1985 expenditure		25 542.5	
Change in %		6.6	
Total expenditure adjusted to take account of expenditure charged in advance in 1983-1984 and 1984-1985 and of the 1985-1986 expenditure carry-over			
☐ 1985-1986 (27 230.0 + 175.0)		27 405.0	
☐ 1984-1985 (25 542.5 + 352.0)		25 894.5	
☐ Change in %		5.8	

* Including $3 800 000 in supplementary estimates for loans and advances.

In the Budgetary and Financial Policy Statement of December 18, 1985, expenditures were forecast at $27 200 000 000, an amount which is $30 000 000 lower than the preliminary figures. This change can be explained principally by overruns on statutory appropriations of $103 000 000 essentially reflecting the $45 900 000 increase in the cost of services provided by the Régie de l'assurance-maladie du Québec and a $42 200 000 increase in charges for servicing the public debt, and by the issuing last February of a special warrant of $58 000 000 to meet additional needs in terms of social aid benefits combined with an increase in lapsed appropriations of $129 900 000.

Supplementary appropriations of $49 500 000 were voted by the National Assembly on June 18, 1985, to fund the additional measures announced in the Budget Speech. These measures concerned mainly the programs for the Regional Development Fund and municipal road works as well as the increase of certain transfers to individuals following tax changes incorporated in the budget.

The supplementary appropriations of $228 739 700 authorized last December contributed to meeting the overruns identified: $35 454 000 for servicing the debt, $28 000 000 for absorbing expenditures pertaining to the holding of the general election of last December 2 and $12 768 800 earmarked for job creation and community works programs. Moreover, $14 925 000 were allocated to financial assistance programs for victims of disasters or criminal acts, $13 104 500 to farm income stabilization insurance and $24 000 000 to subsidies for certain industries.

Furthermore, the preliminary figures incorporate the expenditures incurred for the special warrants of $750 000 issued by the government last November and December in order to create an international assistance fund as well as additional appropriations of $13 200 000 established by the government throughout the fiscal year in accordance with specific legislative provisions.

Unexpended budgetary appropriations totalled $623 200 000, including $8 800 000 in transfers of appropriations to investments, loans and advances.

Unexpended appropriations: $ 623 200 000

The major components of lapsed appropriations include, in particular, $46 500 000 in public service salaries and other remuneration and $53 100 000 for the government's employer contribution to retirement plans resulting from the drop in the interest rate applicable to the retirement plans account, and to the decrease in employee contributions compared to the level anticipated. Expenditures for the current year for health and social service establishments and educational institutions were, respectively, $47 700 000 and $78 900 000 lower than forecast. Interest costs assumed by the government under agricultural financing assistance programs were $28 100 000 lower than anticipated since applications for loans fell short of what had been expected, while lapsed appropriations under the social aid program amounted to $23 000 000, notably reflecting the recovery of overpayments to certain recipients.

Furthermore, the $41 800 000 unexpended balance of Contingency Fund appropriations recorded for the ministère des Finances reflects the constraints in expenditures contained in the Budgetary and Financial Policy Statement.

Finally, the level of regular lapsed appropriations generated by various departmental activities explains the lapsed appropriations balance of $295 300 000, 1.1% of the total authorized appropriations.

Under the budgetary policy adopted by the government for the past few years, the preliminary figures also incorporate an amount of $1 548 700 000 charged to expenditures in 1985-1986 for current and past service under the retirement plans. The following table shows the effects of the retirement plans account on the government's financial transactions since 1980-1981.

SUMMARY OF FINANCIAL TRANSACTIONS RELATING TO THE RETIREMENT PLANS (in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
1. Budgetary transactions						
Revenue	—	—	—	—	—	—
Expenditure	– 895.4	–1 101.1	–1 166.8	–1 232.9	–1 416.6	–1 548.7
Deficit	– 895.4	–1 101.1	–1 166.8	–1 232.9	–1 416.6	–1 548.7
2. Non-budgetary transactions						
Retirement plans account						
☐ Government contributions	+ 895.4	+1 101.1	+1 166.8	+1 232.9	+1 416.6	+1 548.7
☐ Contributions from independent employers	+ 26.0	+ 26.8	+ 25.7	+ 22.6	+ 21.9	+ 22.0
☐ Employee contributions[1]	+ 125.3	+ 143.6	+ 168.0	+ 160.4	+ 153.5	+ 148.2
Total contributions	+1 046.7	+1 271.5	+1 360.5	+1 415.9	+1 592.0	+1 718.9
Total benefits[2] and other payments	– 224.4	– 264.2	– 309.3	– 359.2	– 408.5	– 452.4
Surplus	**+ 822.3**	**+1 007.3**	**+1 051.2**	**+1 056.7**	**+1 183.5**	**+1 266.5**
3. Net financial requirements	– 73.1	– 93.8	– 115.6	– 176.2	– 233.1	– 282.2

N.B.: A (–) sign indicates a financial requirement and a (+) sign, a source of financing.

1 Contributions to retirement plans other than RREGOP. Employee contributions to RREGOP are paid directly to the Caisse de dépôt et placement du Québec without passing through the retirement plans non-budgetary account.

2 Includes the portion of the benefits paid out under RREGOP by the government, and all the benefits paid out under the other plans.

Non-budgetary transactions

Surplus estimated at $1 455 100 000

The non-budgetary transactions surplus totals $1 455 100 000 in the preliminary figures compared to the Budgetary and Financial Policy Statement's forecast $1 430 000 000 of last December. This $25 100 000 increase reflects the additional increase in sources of funds from investments, loans and advances of $18 200 000 and an increase of $40 400 000 in the anticipated level of other non-budgetary accounts, partially offset by a $33 500 000 reduction in the surplus for the retirement plans account.

SUMMARY OF NON-BUDGETARY TRANSACTIONS, 1985-1986 (in millions of dollars)

	Budgetary and Financial Policy Statement 1985-12-18	Preliminary results	Changes
1. Investments, loans and advances			
Enterprises of the gouvernement du Québec			
☐ Share capital and invested capital	– 120.6	– 129.7	– 9.1
☐ Loans and advances	+ 289.0	+ 306.3	+17.3
Subtotal	+ 168.4	+ 176.6	+ 8.2
Loans and advances to municipalities, municipal agencies individuals, corporations and others	– 18.4	– 8.4	+10.0
Total investments, loans and advances	+ 150.0	+ 168.2	+18.2
2. Retirement plans account	+1 300.0	+1 266.5	–33.5
3. Other accounts	– 20.0	+ 20.4	+40.4
4. Balance	+1 430.0	+1 455.1	+25.1

N.B.: A (–) sign indicates a financial requirement and a (+) sign, a source of financing.

The $9 100 000 increase recorded for investments in the form of share capital and other capital invested in government enterprises reflects in particular the $17 400 000 increase in the subscription of share capital of SGF, to enable it to carry out certain development activities, and an increase of $11 000 000 in investment in the Raffinerie du sucre du Québec. Furthermore, an additional subscription of $13 700 000 in share capital of SNA initially anticipated for 1985-1986 was carried over to 1986-1987 whereas the capital investment required in the Société québécoise des transports was $3 400 000 lower than anticipated.

For loans and advances to government enterprises, $17 300 000 more than anticipated were recovered. Of this amount $7 600 000 came from Sidbec and $6 400 000 from the Régie de l'assurance dépots du Québec. The preliminary figures also indicate a $10 000 000 decrease compared to forecasts in the net amount of loans and advances to municipalities, municipal bodies, individuals, firms and others.

The surplus in the retirement plans account, estimated at $1 300 000 000 last December, came to $1 266 500 000. This $33 500 000 drop is the result of a slight reduction in employee contributions and the corresponding employer contribution and lighter than anticipated interest charges on the balance of the account.

The transactions related to other non-budgetary accounts essentially reflect year-to-year changes in the accounts and accrued interest payable and receivable by the government. Such accounts normally change according to the overall volume of financial transactions; however, they may be subject to significant variations which are difficult to forecast from year to year, since they depend basically on the coordination of collection and disbursement transactions. For the 1985-1986 fiscal year, the balance of other accounts shows a net positive change of $20 400 000 compared to the $20 000 000 negative difference forecast in the Budgetary and Financial Policy Statement. This improvement is in large measure due to a $53 300 000 decrease in the level of cash and securities in hand and outstanding deposits at the end of the fiscal year associated with the respective increases of $22 100 000 and $18 200 000 in accounts payable and the clearing account for collected taxes compared to anticipated levels. Moreover, accounts and accrued interest payable amounted to $60 700 000 more than had been forecast.

Repayments of borrowings

Repayments of borrowings estimated at $1 282 100 000

Repayments of borrowings are expected to total $1 282 100 000 for the 1985-1986 fiscal year compared to the amount of $1 068 000 000 in 1984-1985. These preliminary figures are $77 100 000 higher than estimated in the Budgetary and Financial Policy Statement of December 18, 1985. The difference is due to the strong demand for redemption prior to maturity of savings bonds during the first quarter of 1986.

Redemptions of savings bonds during 1985-1986 should total $587 200 000; the total outstanding of such bonds at March 31, 1986, stands at $2 737 300 000.

TOTAL SAVINGS BONDS OUTSTANDING
(in millions of dollars)

Total outstanding as at March 31, 1985		2 667.0
Plus: 1984 issue	1.2[1]	
1985 issue	656.3[2]	657.5
Less: Redemptions		587.2
Total outstanding as at March 31, 1986		**2 737.3**

1 Amount received after March 31, 1985, from the issue of $1 233 663 000.
2 Amount received as at March 31, 1986, from the issue of $657 500 000.

Financing

Borrowings: $ 2 992 600 000

The Québec government borrowed $2 992 600 000 during fiscal 1985-1986, a decrease of $288 400 000 from the amount borrowed the previous year. This considerable decrease may be attributed to the decrease in net financial requirements, which dropped by $297 000 000. Borrowing also enabled the Québec government to slightly improve its cash position during the year.

In 1985-1986, borrowing in Canadian dollars continued to represent the largest portion of government financing, reaching $2 099 900 000 or 70.2% of the total. Financing in U.S. dollars totalled $419 600 000 or 14% of the total and originated essentially from a public issue on the U.S. market for an amount of $273 100 000 and a private placement of $141 300 000. Other loans in foreign currencies resulted from public transactions on German, Japanese and Swiss domestic markets. These loans respectively provided: $182 100 000, 6.1% of total borrowing; $164 700 000, 5.5%; and, $126 300 000, or 4.2%.

Of the $2 099 900 000 borrowed in Canadian currency, $1 180 000 000 were obtained from the Caisse de dépôt et placement du Québec, including $230 000 000 as Treasury bills, and $200 000 000 from public borrowing on the Canadian market, $657 500 000 from the issue of Québec savings bonds and the remainder, $62 400 000, from private borrowing, including borrowing in U.S. dollars equal to $50 000 000 which was simultaneously swapped for a Canadian dollar commitment. Apart from Treasury bills, the amounts borrowed from the Caisse de dépôt et placement du Québec were larger than in 1984-1985 due to the postponement to 1985-1986 of loans scheduled for last year.

The amount issued as Québec savings bonds decreased considerably in 1985-1986 compared to the preceding year. This result is compatible with the government's objectives in this respect. Finally, although the amount of Québec Treasury bills in circulation increased by $230 000 000 during the fiscal year, the portion held publicly did not change.

Private transactions: 46.4 % of borrowings

In 1985-1986, Québec only undertook five financial transactions on the various public capital markets whereas its private transactions enabled it to borrow $1 388 900 000, 46.4% of all borrowings undertaken.

Furthermore, specific features characterized the financial transactions undertaken in 1985-1986. For the first time, the Québec government undertook public borrowings for amounts totalling as much as $200 000 000 on the Canadian market, 300 000 000 DM on the German market and 200 000 000 Swiss francs on the Swiss market. Furthermore, the public borrowing on the Swiss market is for a 20-year term, the longest term ever granted on this market

to a government borrower. The respective maturities of borrowings in U.S. dollars, German marks and Japanese yen were: thirty, twelve and ten years. As a result, the average term of the Québec government bonded debt incurred in 1985-1986 is 17 years.

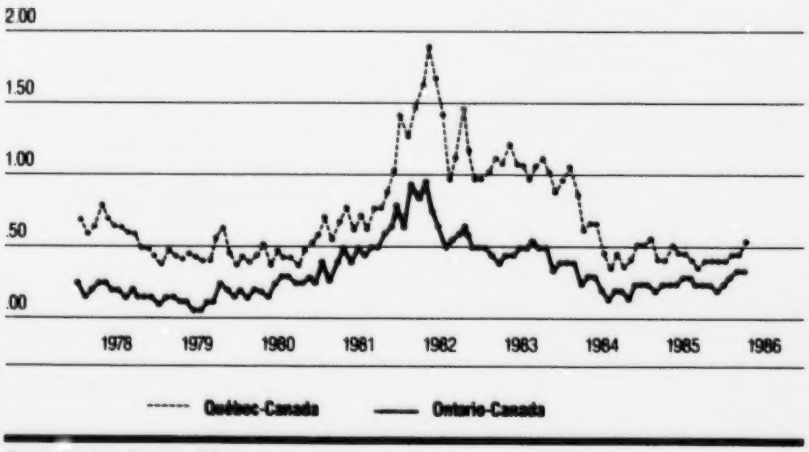
Yield differentials down

Public borrowing on the Canadian market was obtained with yield differentials, compared with Government of Canada securities of equal maturities, among the lowest observed over the past twenty years whereas public borrowing on the U.S. market was conducted with the lowest differentials ever obtained in relation to U.S. government securities of equal maturities.

In addition to the above-mentioned financing transactions which directly affected the 1985-1986 results, the Québec government renegotiated, during the course of the same fiscal year, an existing syndicate credit arrangement totalling a combined amount of $500 000 000 and $250 000 000 in U.S. dollars. This transaction, the largest of this type ever to have been made in Canadian dollars by any borrower, permitted the overall amount available to the government under this arrangement to be increased to $1 000 000 000. Not only did this transaction provide the government with a source of financing at a lower cost than that previously prevailing, but it also substantially extended its financing possibilities by granting it the power to undertake borrowings, issue bills and contract advances in several currencies, up to a sum of $1 000 000 000.

Finally, we should emphasize that the Québec government provided certain government corporations whose loans it guarantees, with technical support and expertise enabling them to refinance in 1985-1986 borrowings totalling $1 179 000 000 at considerably better terms than those prevailing in the past.

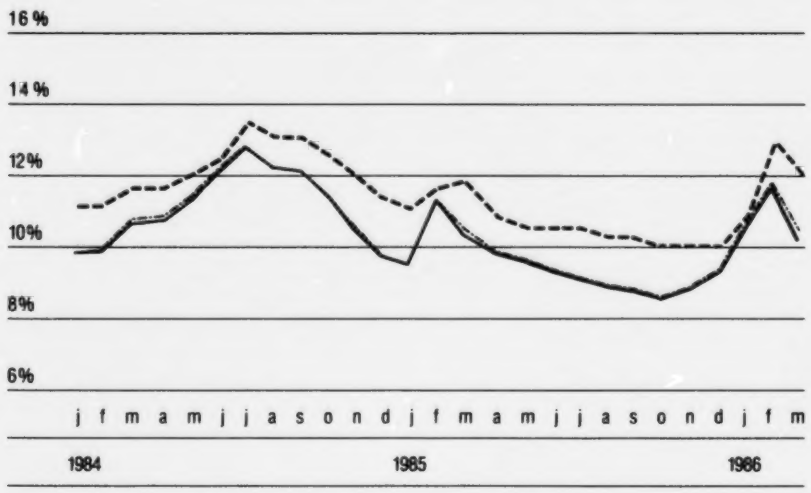
YIELD SPREAD ON QUÉBEC LONG-TERM SECURITIES AND OTHER SECURITIES
(in percentage points)



Source: Dominion Securities Pitfield

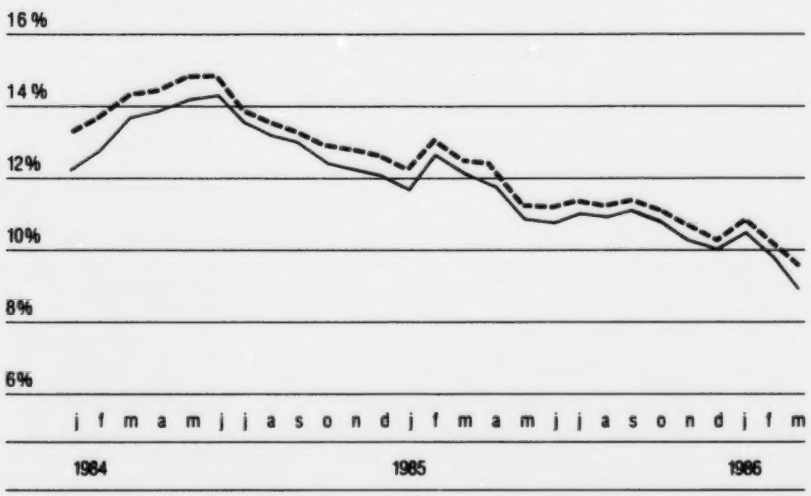
APPENDIX E

YIELD ON SHORT-TERM SECURITIES 1984, 1985 AND 1986


16 %
14 %
12%
10%
8%
6%
j f m a m j j a s o n d j f m a m j j a s o n d j f m
1984
1985
1986
Rate on 3-month Québec Treasury bills
Rate on 3-month Canada Treasury bills
Prime bank loan rate

Sources: Bank of Canada, Dominion Securities Pitfield, Ministère des Finances du Québec.

YIELD ON QUÉBEC AND CANADA LONG-TERM SECURITIES 1984, 1985 AND 1986



Sources: Bank of Canada, Dominion Securities Pitfield, Ministère des Finances du Québec.

The debt

Debt estimated at $22 334 000 000 at March 31, 1986

The Québec government's debt, including total outstanding Treasury bills, stood at $22 334 000 000 as at March 31, 1986. The proportion of the total debt expressed in Canadian dollars declined slightly in 1985-1986, from 73.2% to 71.4%, while that in foreign currencies rose to 28.6%. During the same period, the proportion of the debt at fixed rates rose slightly, from 75.3% to 75.9%; that at variable rates was 24.1% at the end of the 1985-1986 fiscal year. However, certain interest rate and currency exchange transactions, related to the servicing of borrowings made by the government over the past few years, have altered the structure of its debt commitments. In this way, the share of the government's commitments to be met in Canadian dollars for the repayment of its debt was increased to 72.6% of its total debt while the proportion of its commitments bearing interest at fixed rates was increased to 76.2%.

Moreover, new borrowings undertaken in 1985-1986, were secured for longer terms than those on the total debt as at March 31, 1985. As a result, the average term of the government's debt excluding savings bonds and Treasury bills rose from 9.5 years at the end of 1984-1985 to 9.9 years as at March 31, 1986. Total savings bonds outstanding as at March 31, 1986 stand at $2 737 300 000, or 12.3% of the government's total debt. Total Treasury bills outstanding rose to $1 635 000 000, representing 7.3% of the total debt at the end of the fiscal year.

GOVERNMENT DEBT
ESTIMATE AS AT MARCH 31, 1986

Currency of issue	Millions of dollars	Proportion of total (%)
Canadian dollars	15 947	71.4
U.S. dollars	4 109	18.4
German marks	796	3.6
Japanese yen	710	3.2
Pounds sterling	284	1.3
Swiss francs	310	1.4
European units of account	68	0.3
ECUs	58	0.2
Dutch guilders	46	0.2
French francs	6	—
	22 334	100.0

N.B.: The debt in foreign currency is expressed in the Canadian equivalent on the date of borrowings.

Public sector borrowings and investments

Net public sector borrowings: $4 290 000 000, or 4.1% of GDP

During the 1985 calendar year, gross long-term borrowings in the public sector totalled $8 279 000 000, an increase of $1 242 000 000 in relation to the preceding year. This increase in gross borrowings is attributable for the most part to government corporations including Hydro-Québec.

LONG-TERM PUBLIC SECTOR BORROWINGS
(In millions of dollars)

	Calendar year					
	1980	1981	1982	1983	1984	1985[1]
Gross borrowings						
Government[2]	2 734	2 336	2 840	2 405	3 213	3 015
Educational institutions[3]	197	131	244	421	791	705
Health and welfare institutions	107	139	233	92	133	212
Hydro-Québec[2]	2 156	2 257	2 276	1 791	1 100	1 602
Other government corporations[4]	267	449	329	501	599	1 415
Municipal agencies	773	1 045	1 084	938	1 201	1 330
TOTAL	**6 234**	**6 357**	**7 006**	**6 148**	**7 037**	**8 279**
REPAYMENTS[4, 5]	**1 976**	**2 269**	**2 054**	**2 263**	**3 473**	**3 989**
NET BORROWINGS	**4 258**	**4 088**	**4 952**	**3 885**	**3 564**	**4 290**

1 Preliminary results.

2 Amounts received during the calendar year, excluding less-than-one-year net borrowings as long-term financing transactions, which explains the difference between this list and the list of borrowings given later in this text.

3 Including all the universities in Québec, while B.S.Q. statistics consider only the Université du Québec.

4 Amounts revised following a change in the method used to account for renegotiations of borrowings, which are now treated in the same manner as in the financial statements of government corporations.

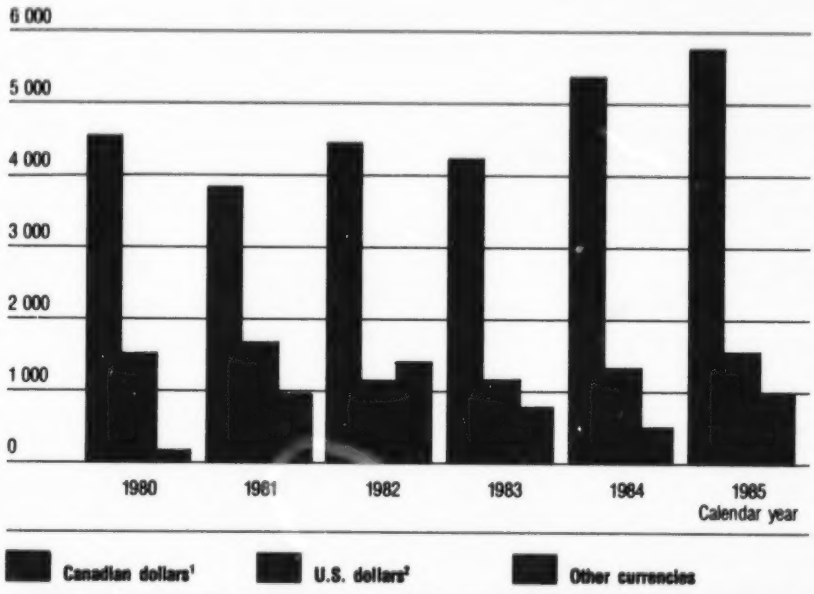
5 Government repayments related to savings bonds have been revised in relation to data published earlier. From now on they are entered according to the year during which the bank accounts are affected rather than according to the date of the accounting entry affecting the consolidated revenue fund.

Source: Ministère des Finances du Québec.

70 % of borrowings in Canadian dollars

Gross borrowings expressed in Canadian dollars totalled $5 771 000 000 in 1985, which represents 70% of total public sector borrowings. Gross borrowings payable in U.S. dollars reached $1 544 000 000, or 18% of total gross borrowings; borrowings in other currencies amounted to $965 000 000, or 12% of the total.

GROSS PUBLIC SECTOR BORROWINGS BY CURRENCY
(in millions of dollars)



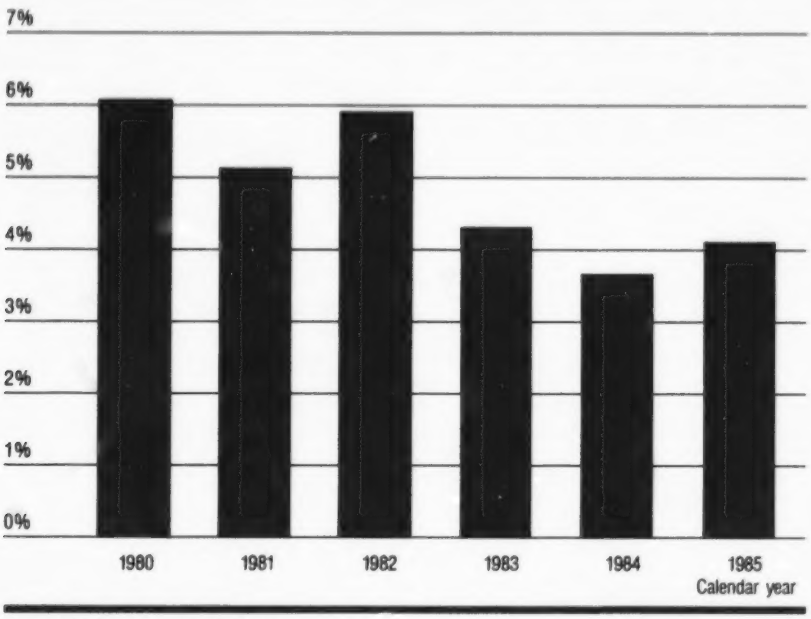
1 Including borrowings on Euromarkets made payable in Canadian dollars in the amount of $100 000 000 in 1980, $250 000 000 in 1981, $896 000 000 in 1982, $262 000 000 in 1983, $513 000 000 in 1984 and $868 000 000 in 1985.

2 Including borrowings on Euromarkets made payable in U.S. dollars in the amount of $539 000 000 in 1980, $795 000 000 in 1981, $442 000 000 in 1982, $255 000 000 in 1983, $818 000 000 in 1984 and $829 000 000 in 1985.

Source: Ministère des Finances du Québec.

Moreover, taking into account refinancing and repayments, net public sector borrowings totalled $4 290 000 000 in 1985. The ratio between net borrowings and gross domestic product was 4.1% in 1985, less than the average for the period covered.

NET PUBLIC SECTOR BORROWINGS AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT



Source: Ministère des Finances du Québec.

PUBLIC SECTOR INVESTMENTS (in millions of dollars)

	Calendar year					
	1980	1981	1982	1983	1984	1985[1]
Government[2]	712	802	712	742	847	877
Educational institutions[3]	213	259	224	289	265	268
Health and welfare institutions[3]	157	166	148	182	203	346
Hydro-Québec[4]	2 592	2 668	2 546	2 248	1 681	1 615
Other government corporations[5]	386	374	342	369	314	682
Municipal agencies[6]	845	961	902	953	1 121	1 531
	4 905	**5 230**	**4 874**	**4 783**	**4 431**	**5 319**

1 Preliminary results.

2 Government investments include its capital expenditures as well as grants and loans for investments made available to economic agents outside the public sector. Financial investments within the public sector are excluded.
Sources: The Estimates and Public Accounts.

3 Investments by school boards, Cegeps and universities, as well as health and welfare institutions, include only capital expenditures for new projects, as defined for the purposes of economic accounting.
Sources: Investissements publics au Québec par région administrative, B.S.Q.; Investissements privés et publics au Québec, B.S.Q.

4 Source: Hydro-Québec.

5 Government corporation investments correspond to an increase in long-term assets. Investments of the Société québécoise d'assainissement des eaux are included under "municipal agencies".
Source: Financial statements of government corporations.

6 Investments by municipalities, urban and regional communities and transport commissions and corporations include only capital expenditures for new projects, as defined for the purposes of economic accounting.
Source: Ministère des Finances du Québec estimates.

Public sector investments: 20 % increase to $5 319 000 000

In 1985, public sector investments totalled $5 319 000 000, an increase of 20% from 1984. As the preceding table indicates, this increase is particularly attributable to government corporations, health and welfare institutions and the municipalities.

In order to take into account the interrelationships between the government's financial policy and the state of the various sectors under its jurisdiction, comparative changes in borrowings and investments must take into account the situation of the public sector as a whole. Total net public sector borrowings include, in addition to the net long-term borrowings mentioned earlier, less-than-one-year net borrowings made as long-term financing transactions, including Treasury bills issued by the government, as well as borrowings from the surplus in the government's retirement plans account.

TOTAL NET BORROWINGS AND INVESTMENTS BY THE PUBLIC SECTOR (in millions of dollars)

	Calendar year					
	1980	1981	1982	1983	1984	1985[1]
Net long-term borrowings	4 258	4 088	4 952	3 885	3 564	4 290
Less-than-one-year net borrowings as long-term financing transactions	415	395	309[2]	636[3]	−20[4]	506[5]
Surplus in the government retirement plans account	787	961	1 040	1 055	1 152	1 248
Total net borrowings	5 460	5 444	6 301	5 576	4 696	6 044
Investments	4 905	5 230	4 874	4 783	4 431	5 319
Ratio	1.11	1.04	1.29	1.17	1.06	1.14

1 Preliminary results.

2 Including $300 000 000 in government treasury bills.

3 Including $310 000 000 in government Treasury bills.

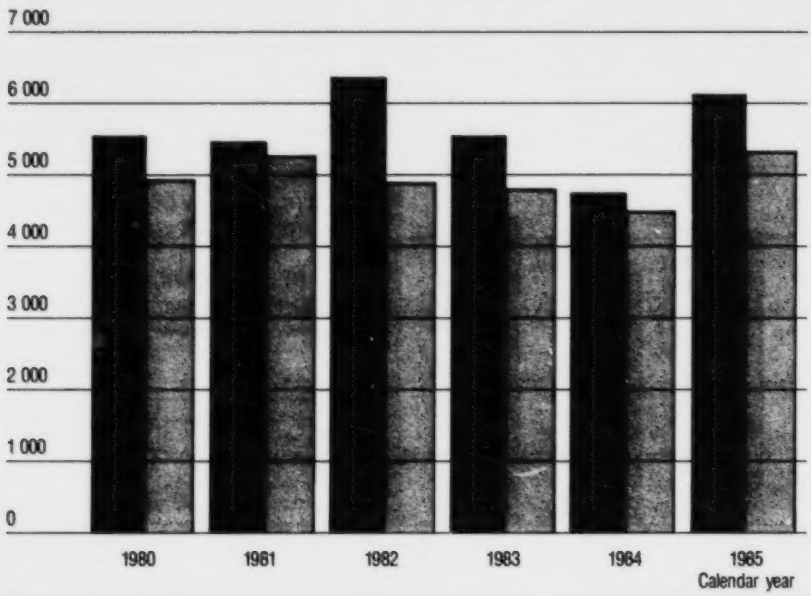
4 Including −$15 000 000 in government Treasury bills.

5 Including $150 000 000 in government Treasury bills.

Source: Ministère des Finances du Québec.

In 1985, total net public sector borrowings are estimated at $6 044 000 000, an increase of $1 348 000 000 in relation to 1984. Thus, the ratio of total net borrowings to investments is 1.14 in 1985, a level equivalent to that recorded on the average for the entire period in question.

TOTAL NET BORROWINGS AND INVESTMENTS BY THE PUBLIC SECTOR
(in millions of dollars)



Less-than-one-year net borrowings as long-term financing transactions

Net long-term borrowings

Surplus in the government retirement plans account

Investments

Source: Ministère des Finances du Québec.

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
SUMMARY
(in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986[1]
1. Budgetary transactions						
Revenue	+14 694.0	+17 481.7	+19 210.3	+21 410.9	+22 310.0	+24 078.0
Expenditure	−17 592.0	−20 393.4	−22 259.3	−24 523.5	−25 542.5	−27 230.0
Deficit	− 2 898.0	− 2 911.7	− 3 049.0	− 3 112.6	− 3 232.5	− 3 152.0
2. Non-budgetary transactions						
Investments, loans and advances	− 40.4	− 72.9	− 135.0	− 150.5	− 171.8	+ 168.2
Retirement plans account	+ 822.3	+ 1 007.3	+ 1 051.2	+ 1 056.7	+ 1 183.5	+ 1 266.5
Other accounts	− 196.6	− 169.0	− 103.5	− 14.4	+ 218.8	+ 20.4
Balance	+ 585.3	+ 765.4	+ 812.7	+ 891.8	+ 1 230.5	+ 1 455.1
3. Net financial requirements	− 2 312.7	− 2 146.3	− 2 236.3	− 2 220.8	− 2 002.0	− 1 696.9
4. Financing						
Change in cash position	− 456.1	+ 207.9	− 75.5	− 13.7	− 211.0	− 13.6
New borrowings	+ 3 352.9	+ 2 951.6	+ 2 761.8	+ 2 797.0	+ 3 281.0	+ 2 992.6
Less: Repayments of borrowings	− 584.1	− 1 013.2	− 450.0	− 562.5	− 1 068.0	− 1 282.1
Total	**+ 2 312.7**	**+ 2 146.3**	**+ 2 236.3**	**+ 2 220.8**	**+ 2 002.0**	**+ 1 696.9**

N.B.: A (−) sign indicates a financial requirement and a (+) sign, a source of financing. For the change in cash position, a (−) sign indicates an increase and a (+) sign, a decrease.

For comparison purposes, the financial data shown are based on the budgetary and financial structure in force for the 1986-1987 fiscal year.

1 The financial data shown in this table for 1985-1986 are determined on the basis of the results recorded for the period of April 1985 to March 1986 and of an estimate as at April 23, 1986, of revenue and expenditure posted to the lapsed fiscal year, in April 1986, according to the accounting policies in effect.

APPENDIX E

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
BUDGETARY REVENUE
(in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
1. Income and property taxes						
Personal income tax	5 315.9	6 053.1	6 311.3	6 763.7	7 126.9	7 980.0
Employer contributions to health services fund	601.9	1 275.0	1 337.1	1 440.8	1 509.5	1 604.0
Corporate taxes[1]	913.4	1 010.5	898.4	860.3	996.4	1 085.0
Succession duties	39.8	37.8	45.0	46.7	45.1	31.0
	6 871.0	**8 376.4**	**8 591.8**	**9 111.5**	**9 677.9**	**10 700.0**
2. Consumer taxes						
Retail sales	1 690.2	1 771.3	1 936.7	2 277.4	2 575.1	3 171.0
Fuel	492.7	826.9	1 194.9	1 207.5	1 030.4	1 079.0
Tobacco	179.3	228.6	277.0	312.6	373.5	546.0
Meals and hotel	209.7	236.6	249.3	274.5	303.4	328.0
Other[2]	62.0	79.2	89.2	102.6	112.4	127.0
	2 633.9	**3 142.6**	**3 747.1**	**4 174.6**	**4 394.8**	**5 251.0**
3. Duties and permits						
Motor vehicles	193.7	224.7	285.4	259.6	273.3	279.0
Alcoholic beverages	55.7	62.8	58.8	65.0	67.2	69.0
Natural resources[3]	124.1	143.2	86.5	83.1	96.2	93.0
Pari-mutuel	33.9	33.3	31.5	31.1	29.7	27.0
Other	52.2	51.9	65.1	71.8	70.9	82.0
	459.6	**515.9**	**527.3**	**510.6**	**537.3**	**550.0**
4. Miscellaneous						
Sale of goods and services	166.7	181.6	217.7	301.2	226.5	215.0
Interest	184.8	221.6	294.6	277.8	269.5	234.0
Fines, confiscations and recoveries	68.3	90.2	95.5	108.5	92.7	113.0
	419.8	**493.4**	**607.8**	**687.5**	**588.7**	**562.0**
5. Transfers from government corporations						
Société des alcools du Québec	203.0	225.0	275.0	325.0	352.0	355.0
Loto-Québec	135.0	150.0	162.0	205.0	240.0	310.0
Hydro-Québec	—	6.9	7.0	60.2	155.8	—
Other government corporations	—	—	—	—	—	37.0
	338.0	**381.9**	**444.0**	**590.2**	**747.8**	**702.0**
Total own-source revenue	**10 722.3**	**12 910.2**	**13 918.0**	**15 074.4**	**15 946.5**	**17 765.0**
6. Government of Canada transfers						
Equalization	1 847.2	2 317.8	3 071.9	3 227.4	3 101.6	2 854.0
Other transfers related to the fiscal arrangements	1 189.2	1 225.8	1 101.3	1 720.8	1 833.4	1 942.0
Contributions to welfare programs	586.7	663.7	822.8	1 043.7	1 147.8	1 198.0
Other programs	348.6	364.2	296.3	344.6	280.7	319.0
Total Government of Canada transfers	**3 971.7**	**4 571.5**	**5 292.3**	**6 336.5**	**6 363.5**	**6 313.0**
Total budgetary revenue	**14 694.0**	**17 481.7**	**19 210.3**	**21 410.9**	**22 310.0**	**24 078.0**

1 Includes tax on corporate profits, tax on capital, excluding insurance companies, and premium tax.

2 Includes tax on telecommunications and on electronic advertising.

3 Includes forest, mining and water resources.

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
BUDGETARY EXPENDITURE
(In millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
Affaires culturelles	119.3	128.3	141.3	153.6	179.8	204.9
Affaires municipales	474.3	594.8	650.3	712.9	687.6	723.0
Agriculture, Pêcheries et Alimentation	350.7	378.1	429.7	415.6	461.4	516.5
Assemblée nationale	28.3	32.4	35.3	39.7	46.3	63.2
Commerce extérieur et Développement technologique	5.4	5.9	10.5	13.5	18.2	24.9
Communautés culturelles et Immigration	26.8	21.3	23.8	24.1	27.7	27.9
Communications	139.1	155.5	175.4	194.9	207.6	227.8
Conseil exécutif	28.5	25.3	23.3	25.4	37.0	47.1
Conseil du trésor	9.3	11.0	13.8	12.3	12.7	16.0
Éducation	3 445.9	4 067.5	4 098.8	4 463.8	4 051.3	4 480.4
Énergie et Ressources	204.2	253.5	248.1	281.3	349.1	354.5
Enseignement supérieur et Science	1 638.5	1 877.0	2 005.2	2 136.8	2 257.6	2 377.9
Environnement	83.0	89.8	111.4	123.5	141.5	169.2
Finances	1 275.0	1 737.6	1 988.8	2 368.2	2 507.0	2 835.2
Industrie et Commerce	114.2	116.5	126.2	258.4	326.8	326.6
Justice	190.2	214.3	232.2	245.2	261.5	352.1
Loisir, Chasse et Pêche	187.1	186.4	199.6	216.3	226.1	224.4
Main-d'oeuvre et Sécurité du revenu	1 474.1	1 631.0	2 017.8	2 431.7	2 617.3	2 881.4
Office de planification et de développement du Québec	27.6	21.8	28.0	44.3	52.8	45.2
Organisme relevant du ministre délégué à l'Administration	444.8	560.0	608.4	659.0	761.4	833.8
Organismes relevant de la ministre déléguée à la Condition féminine	29.6	34.0	42.7	50.3	56.3	73.1
Organismes relevant de la Vice-présidente du Conseil exécutif	80.9	129.5	141.5	156.4	164.0	172.0
Organismes relevant du ministre délégué aux Services et Approvisionnements	12.3	19.4	19.3	16.4	146.7	29.2
Personnes désignées par l'Assemblée nationale	65.3	36.5	17.7	18.9	38.6	62.3
Régie de l'assurance-maladie du Québec	1 083.7	1 173.4	1 162.6	1 356.6	1 456.5	1 622.5
Relations internationales	43.2	41.0	42.4	45.1	51.3	58.1
Revenu	186.1	196.7	213.9	240.3	231.2	251.3
Santé et Services sociaux	3 920.7	4 563.6	5 216.8	5 464.2	5 797.7	5 949.7
Solliciteur général	309.0	362.7	389.5	405.7	444.7	473.3
Tourisme	21.8	25.6	31.2	40.0	68.5	75.1
Transports	1 298.9	1 384.7	1 482.4	1 578.9	1 631.6	1 669.3
Travail	40.4	68.5	64.8	68.7	72.8	62.1
Travaux publics et Approvisionnement	233.8	249.8	266.6	261.5	151.9	—
Total budgetary expenditure	**17 592.0**	**20 393.4**	**22 259.3**	**24 523.5**	**25 542.5**	**27 230.0**

APPENDIX E

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
NON-BUDGETARY TRANSACTIONS
(in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
1. Investments, loans and advances						
ENTERPRISES OF THE GOUVERNEMENT DU QUÉBEC						
SHARE CAPITAL AND INVESTED CAPITAL						
Sidbec	− 55.2	−20.4	—	—	—	—
Société de récupération, d'exploitation et de développement forestiers du Québec (REXFOR)	− 22.2	—	—	—	− 0.5	− 18.8
Société générale de financement du Québec (SGF)	− 25.0	−33.0	− 40.0	− 31.0	− 51.5	− 49.4
Société nationale de l'amiante (SNA)	− 19.7	− 6.8	− 12.2	− 10.7	− 35.0	− 35.3
Société québécoise d'exploration minière (SOQUEM)	− 24.5	—	—	− 10.0	− 11.6	—
Société québécoise d'initiatives agro-alimentaires (SOQUIA)	− 3.0	—	− 5.0	− 6.4	− 5.4	− 4.0
Société québécoise d'initiatives pétrolières (SOQUIP)	− 9.8	−22.5	− 26.5	− 30.0	− 39.9	—
Other	− 14.3	− 3.6	− 20.8	− 46.7	− 23.6	− 22.2
	−173.7	**−86.3**	**−104.5**	**−134.8**	**−167.5**	**−129.7**
LOANS AND ADVANCES						
Office du crédit agricole du Québec	+ 53.8	+47.2	+ 16.6	+ 12.1	+ 11.9	+160.0
Sidbec	− 10.0	− 1.4	− 10.1	− 12.5	− 36.8	+ 9.6
Société d'habitation du Québec (SHQ)	+ 1.3	+ 7.2	− 1.2	+ 6.7	+ 11.8	+ 1.5
Société immobilière du Québec (SIQ)	—	—	—	—	—	+147.0
Other	+ 98.6	− 8.7	+ 0.2	− 14.2	− 0.4	− 11.8
	+143.7	**+44.3**	**+ 5.5**	**− 7.9**	**− 13.5**	**+306.3**
Total enterprises of the gouvernement du Québec	**− 30.0**	**−42.0**	**− 99.0**	**−142.7**	**−181.0**	**+176.6**
MUNICIPALITIES AND MUNICIPAL AGENCIES	+ 1.4	+ 1.5	+ 1.6	+ 1.6	+ 1.5	+ 1.4
INDIVIDUALS, CORPORATIONS AND OTHERS	− 11.8	−32.4	− 37.6	− 9.4	+ 7.7	− 9.8
Total investments, loans and advances	**− 40.4**	**−72.9**	**−135.0**	**−150.5**	**−171.8**	**+168.2**

GOUVERNEMENT DU QUÉBEC
STATEMENT OF FINANCIAL TRANSACTIONS
NON-BUDGETARY TRANSACTIONS (cont'd.)
(in millions of dollars)

	1980-1981	1981-1982	1982-1983	1983-1984	1984-1985	Preliminary results 1985-1986
2. Retirement plans account						
EMPLOYER AND EMPLOYEE CONTRIBUTIONS						
Contributions by the government as an employer:						
RREGOP						
Current service	+ 388.5	+ 418.6	+ 353.9	+ 302.2	+ 314.7	+ 317.8
Interest	+ 130.8	+ 192.0	+ 259.6	+ 313.6	+ 379.4	+ 438.8
Other plans						
Current service	+ 169.6	+ 194.8	+ 186.9	+ 172.0	+ 167.1	+ 164.7
Past service	+ 172.7	+ 224.3	+ 246.5	+ 278.4	+ 337.0	+ 360.3
Interest	+ 33.8	+ 71.4	+ 119.9	+ 166.7	+ 218.4	+ 267.1
Total	**+ 895.4**	**+1 101.1**	**+1 166.8**	**+1 232.9**	**+1 416.6**	**+1 548.7**
Independent agencies						
Current service	+ 8.0	+ 8.8	+ 7.7	+ 5.6	+ 4.9	+ 5.0
Past service	+ 18.0	+ 18.0	+ 18.0	+ 17.0	+ 17.0	+ 17.0
Total	**+ 26.0**	**+ 26.8**	**+ 25.7**	**+ 22.6**	**+ 21.9**	**+ 22.0**
Employee contributions	+ 125.3	+ 143.6	+ 168.0	+ 160.4	+ 153.5	+ 148.2
Total contributions	**+1 046.7**	**+1 271.5**	**+1 360.5**	**+1 415.9**	**+1 592.0**	**+1 718.9**
BENEFITS AND OTHER PAYMENTS						
Benefits and refunds	− 203.7	− 238.4	− 287.8	− 340.2	− 389.6	− 433.5
Other outlays	− 20.7	− 25.8	− 21.5	− 19.0	− 18.9	− 18.9
Total	**− 224.4**	**− 264.2**	**− 309.3**	**− 359.2**	**− 408.5**	**− 452.4**
Total retirement plans account	**+ 822.3**	**+1 007.3**	**+1 051.2**	**+1 056.7**	**+1 183.5**	**+1 266.5**
3. Other accounts						
Cash and negotiable securities in hand and outstanding deposits	+ 7.5	+ 0.7	+ 4.2	− 21.2	− 15.4	+ 50.3
Outstanding cheques	+ 21.1	− 90.4	+ 134.0	− 108.2	+ 89.2	+ 36.9
Clearing accounts for collected taxes	+ 8.6	+ 46.7	+ 4.0	− 6.0	+ 18.5	+ 35.2
Accounts receivable	− 106.3	− 409.3	− 292.0	− 197.1	− 103.3	− 243.4
Accrued interest receivable	+ 0.5	+ 1.7	− 0.3	+ 4.3	+ 1.0	− 7.3
Advances from the trust funds	+ 4.5	− 0.7	+ 4.9	+ 2.8	+ 3.0	+ 1.6
Accounts payable	− 273.9	+ 183.2	− 151.9	+ 221.5	+ 47.3	+ 67.1
Accrued interest payable	+ 141.4	+ 99.1	+ 193.6	+ 89.5	+ 178.5	+ 80.0
Total other accounts	**− 196.6**	**− 169.0**	**− 103.5**	**− 14.4**	**+ 218.8**	**+ 20.4**
Total non-budgetary transactions	**+ 585.3**	**+ 765.4**	**+ 812.7**	**+ 891.8**	**+1 230.5**	**+1 455.1**

LIST OF BORROWINGS BY THE GOUVERNEMENT DU QUÉBEC IN 1985-1986

Amount in Canadian dollars[1]	Face value in foreign currency	Interest rate[2]	Date of issue	Date of maturity	Price to buyer	Yield to buyer[3]
(In millions)		%			$	%
100.0[4]		12.75	May 8	2004-11-29	102.98	12.34
100.0[4]		12.25	May 30	2005-06-30	100.72	12.15
50.0[5]	36.5 US	11.00*	May 31	1997-05-31	100.00	10.71
1.2[6]		11.75-8.50*	June 1, 1984	1994-06-01	100.00	—
656.3[7]		9.00-7.50*	June 1	1995-06-01	100.00	—
164.7	30 000.0 ¥	7.00	June 7	1995-06-07	99.80	7.03
273.1	200.0 US	11.00	June 15	2015-06-15	99.75	11.03
104.0		10.50	June 26	1995-06-26	99.35	10.61
5.0[8]		10.50	June 26	1995-06-26	99.35	10.61
96.0		10.75	June 26	2009-06-26	98.50	10.93
75.0[4]		10.75	June 26	2009-06-26	98.50	10.93
50.0[4]		10.50	July 31	1990-07-31	99.81	10.55
50.0[4]		10.75	July 31	1998-07-31	98.63	10.95
50.0[4]		10.75	July 31	2009-06-26	97.06	11.10
75.0[4]		10.75	October 3	1990-10-03	100.11	10.72
75.0[4]		11.375	October 3	2005-10-03	99.65	11.42
126.3	200.0 SF	5.50*	November 6	2005-11-06	100.00	5.43
50.0[4]		9.75	December 23	1991-01-15	99.11	9.97
100.0[4]		10.50	December 23	1997-01-15	99.885	10.52
225.0[4]		10.50	December 23	2001-01-15	99.17	10.61
182.1	300.0 DM	6.50*	March 1	1998-03-01	100.00	6.40
141.3	130.0 US	7.15*[9]	March 12	2001-03-12	76.885	9.98
5.8[10]		Miscellaneous	Varied	2005-2006	100.00	Miscellaneous
6.8[11]		Miscellaneous	Varied	Varied	Miscellaneous	Miscellaneous
230.0[4,12]		Miscellaneous	Varied	Varied	Miscellaneous	Miscellaneous
2 982.6						

* Interest payable annually.

1 Canadian equivalent of face value on the date of borrowing for loans in foreign currency.

2 Interest payable semi-annually, except that on Treasury bills, which is payable upon maturity, and that marked with an asterisk, which is payable annually.

3 Yield to buyer is determined on the basis of interest payable every six months.

4 The Caisse de dépôt et placement du Québec subscribed for these bond issues.

5 This borrowing was the object of simultaneous exchange coverage in Canadian dollars.

6 Amount cashed from the June 1, 1984 savings bond issue. The interest rate on these bonds was 11.75% until May 31, 1985, and 9% until February 28, 1986. It was increased to 10% until May 31, 1986, and will be 8.50% thereafter until May 31, 1994.

7 Amount cashed from the June 1, 1985 savings bond issue. The interest rate on these bonds was 9% until February 28, 1986 and increased to 10% until May 31, 1986. It will be 7.50% thereafter until May 31, 1995.

8 Borrowing from Hydro-Québec pension fund.

9 Effective rate to buyer is 10.23% and the terms of the loan provide for a total face value at maturity of $130 000 000 US on paid capital of $99 950 000 US.

10 Borrowings from the Government of Canada under the Canada Pension Plan.

11 Interest capitalized on four discount loans, one of which was issued in June 1982 and the three others in January and February 1985, including $5 200 000 referring to borrowings in U.S. dollars.

12 Net amount of Treasury bills issued between April 1, 1985, and March 31, 1986.

N.B.: The gouvernement du Québec made credit agreements with various international banks and financial institutions for $1 000 000 000 US and $1 250 000 000, that can be drawn in Canadian dollars or their equivalent, up to $1 000 000 000 in US dollars or other currencies. At March 31, 1986, balances available under these agreements were $150 000 000 US and $1 188 500 000 respectively, which can be drawn in Canadian dollars or their equivalent, up to $938 500 000 in US dollars or other currencies.

LIST OF BORROWINGS BY HYDRO-QUÉBEC IN 1985

Amount in Canadian dollars[1]	Face value in foreign currency	Interest rate[2]	Date of issue	Date of maturity	Price to buyer	Yield to buyer[3]
(in millions)		%			$	%
50.0		12.375	January 3	1991-01-03	99.90	12.40
88.1		10.00	January 15	1997-06-01	88.125	11.84
266.6	200.0 US	11.75	February 1	2012-02-01	99.60	11.80
117.0[6]		11.00	February 6	1990-02-06	99.45	11.15
153.0		12.25	February 6	2006-02-06	100.00	12.25
100.0		12.25 *	May 1	1995-05-01	100.00	11.90
25.0		(4)	May 6	1990-05-06	99.89	9.90
89.3	200.0 DM	7.125*	June 20	1995-06-20	100.00	7.00
55.0[6]		11.00	July 10	1990-02-06	101.75	10.50
50.1		8.00 *	August 15	1995-03-15	83.11	10.71
100.0		11.00 *	August 15	1995-08-15	100.50	10.63
170.0		10.75	September 25	1995-09-25	98.875	10.94
100.0		11.25	September 25	2008-09-25	99.75	11.28
143.2	25 000 ¥	8.00 *	October 17	1995-07-17	101.50	7.62
50.0		(5)	December 20	1991-02-18	100.00	9.57
40.0		12.00-12.05	Varied	1986	—	—
1.4	1.0 US	9.20	Varied	1988	—	—
1 588.7[7]						

* Interest payable annually.

1 Canadian equivalent of face value on the date of borrowing for loans in foreign currency.

2 Interest payable semi-annually, except that marked with an asterisk, which is payable annually.

3 Yield to the buyer is determined on the basis of interest payable every six months.

4 Prime rate of the National Bank of Canada and of the Banque d'Épargne less 0.625%. The amount of $25 000 000 represents the portion added to the outstanding amount following borrowing renegotiation; the proceeds of $100 000 000 then received mainly served to replace a $75 000 000 borrowing.

5 Variable rate equal to the yield on 91-day Canada Treasury bills increased by 0.50%. This issue is not guaranteed by the gouvernement du Québec.

6 The Caisse de dépôt et placement du Québec subscribed partly for these bond issues.

7 This total does not include $3 500 000 in capitalized interest.

N.B.: At December 31, 1985, Hydro-Québec had credit agreements of $750 000 000 available in US dollars or its equivalent in Canadian dollars.

APPENDIX F

Fiscal Arrangements: Contracting-out by the Federal Government?

Introduction 3

Reminder of cuts imposed in 1982-1987 fiscal arrangements 4

Equalization 4
Health and post-secondary education financing 6
Recurrent effects of past cuts 7
Transfers to the provinces are not the cause of the federal deficit 8

Present federal government policies on fiscal arrangements 9

The federal government's approach 9
Bill C-96 10
Short-term financial effects of Bill C-96 10
Long-term financial effects of Bill C-96: Contracting-out by the federal government? 11
Inconsistency of federal government budget choices 13
Worsening of interprovincial disparities 13
Consequences of Bill C-96 for Québec government budget choices 15

Québec's approach to federal-provincial financial relations 16

Basic principles to be respected 16
— *Respect for expiry dates* 16
— *Respect for the Constitution* 16
— *Limiting the federal government's power to act unilaterally* 16
— *Financial resources geared to provincial responsibilities* 17
— *Respect for the provinces' budget choices* 17
— *Global negotiations* 18
Proposal for transfer programs 18
— *Equalization* 18
— *Canada Assistance Plan* 18
— *Health and post-secondary education financing* 19

Conclusion 20

Supplementary information: Impact of federal cuts in the EPF since 1982 — Québec and all provinces —

Introduction

Close to a quarter of Québec's budgetary revenue comes from the financial transfers made by the federal government under the heading of equalization, Established Programs Financing (EPF) for health and post-secondary education, and the Canada Assistance Plan (CAP). Although the public assistance cost-sharing formula has not changed since 1966, the equalization program and the EPF are reviewed every five years in principle, at the time of the federal-provincial negotiations on the fiscal arrangements.

The federal government nevertheless assumes the right to act unilaterally and change the transfer mechanisms without consulting the provinces. Since the beginning of the 1980s, it has done this several times with a view to reducing its payments to the provinces.

Federal transfers cut by $8 000 000 000 by 1992

Its latest intervention was the presentation in the House of Commons, on February 14, 1986, of Bill C-96, which is designed to reduce the rate of growth of federal transfers for health and post-secondary education. Therefore, as of April 1, 1986, a year before the normal expiry date of the current fiscal arrangements, the federal government decided that its contribution to the EPF would no longer increase at the same rate as the growth of the economy, as was provided in 1977, but at this rate reduced by two percentage points. The federal Minister of Finance is counting on reaching the objective set forth in the May 1985 federal budget, i.e. a reduction in transfers to the provinces amounting to $2 000 000 000 in 1990-1991. To this end, he plans to reduce transfers to the provinces by a cumulative total of more than $8 000 000 000 by 1992.

Bill C-96: a shortfall of $82 000 000 in 1986-1987 for Québec, rising to $512 000 000 in 1990-1991

The cuts provided for in Bill C-96 would have a major impact on the Québec government's financial framework. These would result in annual losses rising from $82 000 000 in 1986-1987 to $512 000 000 in 1990-1991, and would total more than $2 000 000 000 by 1992. In addition, they would add to the recurrent effects of the cuts imposed since 1982 in equalization and the EPF, at a time when Québec's public finances are of particular concern, as was indicated in the paper published by the Québec Minister of Finance last March 5, entitled **Québec's Public Finances: The Need for Immediate Action.**

It is against this rather sombre background that we must discuss the fiscal arrangements between the federal government and the provinces.

This paper begins with a reminder of the cuts in transfers made since 1982 and their effects on Québec's public finances in the coming years. The parallel between the cuts in transfers and the changes in other federal expenditures will prove that transfers to provinces are not the cause of the federal deficit.

Federal contracting-out must be negotiated with the provinces

The second section will show the effects of the new cuts made under Bill C-96. It will be seen that the impact of the federal government's reform is so strong that it will mean, in the medium term, de facto contracting-out by the federal government from such important sectors as health and higher education. At the same time, however, the federal government imposes standards in the health sector and is increasing its threats to intervene in the higher education sector. The Québec government is not opposed in principle to a degree of opting out by the federal government, but it cannot agree to its doing so without consulting the provinces and with no fiscal compensation. Also, this transfer of deficit from one level of government to another means difficult budgetary choices for the Québec government in order to make up the losses suffered by the Québec treasury.

Finally, this appendix will discuss the Québec government's approach to federal-provincial financial relations; certain principles will be formulated and a preliminary solution will be proposed.

Reminder of cuts imposed in 1982-1987 fiscal arrangements

The 1977 round of negotiations resulted in a certain consensus with regard to the Established Programs Financing (EPF). The federal government's overall contribution to health and post-secondary education programs was, from this time on, tied to the growth in economic (GNP) and demographic indicators rather than to strict sharing of provincial expenditures.

Since 1982, unilateral reopening of the fiscal arrangements

On the other hand, the 1981-1982 negotiations resulted in a struggle between the two levels of government. The 1982-1987 fiscal arrangements, which were imposed on the provinces, introduced basic changes in the equalization and EPF programs. In addition, the federal government has intervened on several occasions in these two programs since 1982, unilaterally reopening the Fiscal Arrangements Act with the intention of either changing the orientation it had until then chosen to follow or increasing its harmful effects.

Equalization

In 1982, the federal government made a number of very important changes in the equalization program. The extent of these changes constitutes a threat to the very spirit of the program, now enshrined in the Canadian Constitution, for they mean a reduction in equalization payments to Québec, thereby forcing it to increase the burden on its taxpayers in order to maintain public services comparable to those offered in the other provinces.

The first change consisted in the exclusion of Alberta and the Atlantic provinces from the calculation of the fiscal capacity standard. Each province's wealth is now compared with that of the five so-called representative provinces[1] rather than with the national average.

The federal government also decided to enlarge the definition of provincial revenues from taxation and fees subject to the equalization process under the program. Thus, municipal revenue, which was once excluded, is now subject to equalization. Also, 100% of the revenues from natural resources now come under the program while it was only 50% in 1981-1982.

Transitional guarantee

The net effect of these two major changes was to appreciably reduce equalization payments to Québec and Manitoba. To mitigate this, the federal government introduced a transitional guarantee under which equalization payments were subject to a floor for the first three years, i.e. 1982-1983 to 1984-1985. According to federal estimates at the time, the transitional provision would soften the effects of the changeover from the old to the new equalization formula, no province having to suffer a drop in payments from one year to the next throughout the entire 1982-1987 period.

Three problems for Québec

The changes made in the equalization program in 1982 pose three series of problems for Québec:

☐ First, equalization payments to Québec have not increased at a sufficient rate since the new program was set up.

1 Québec, Ontario, Manitoba, Saskatchewan, British Columbia.

Whereas equalization payments represented 16% of Québec's budgetary revenue in 1982-1983, they will represent no more than 11% in 1986-1987.

☐ Second, during the negotiations on renewal of the fiscal arrangements, the federal government said, in 1981: "... Ontario appears to be the most suitable reference province for determining an adequate equalization standard. Adoption of a lower standard would not meet the purpose of the program."[1] But it must be recognized that the new formula introduced in 1982 only increased the spread between the fiscal capacities of Ontario and Québec. Although Québec reached parity with Ontario in this respect in 1979-1980 and 1980-1981, the new formula enabled Québec to reach only 94.3% of Ontario's fiscal capacity in 1985-1986. **If Québec had remained in a state of parity with Ontario, it would receive an additional $1 200 000 000 in equalization payments in 1985-1986.**

☐ Third, as early as 1984-1985 it had become clear that the transitional guarantee was not fulfilling its purpose, which was to assure the provinces of regular annual growth of their entitlements from 1982-1983 to 1986-1987. The expiry of this guarantee caused, in 1985-1986, a drop in the payments to four provinces, including Québec, in relation to the preceding year.

Faced with the latter problem, the federal government decided on April 1, 1985, under a special act, to grant the provinces supplementary equalization payments. This act provided for lump sum payments to be distributed in the following way:

SUPPLEMENTARY EQUALIZATION PAYMENTS
(in millions of dollars)

	1985-1986	1986-1987
Newfoundland	15	—
Prince Edward Island	5	—
Nova Scotia	20	—
New Brunswick	20	—
Québec	**110**	—
Manitoba	50	65[1]

1 Equalization payments to Manitoba were also to fall in 1986-1987, so the supplementary payments for this province were paid for two years.

On the basis of the first federal estimate[2] for 1985-1986, these payments represented a guaranteed 95% of 1984-1985 entitlements for Québec, Manitoba and Nova Scotia. For the provinces whose equalization entitlements fell by less than 5% (Prince Edward Island) or increased (Newfoundland and New Brunswick) in 1985-1986, the federal government decided, nevertheless, to pay the same per capita amount as for the first three provinces. All the recipient provinces therefore received supplementary payments.

However, on the basis of the latest data for 1985-1986, supplementary equalization payments failed to provide Québec's guaranteed 95% but only 92.8% of the preceding year's payments, **resulting in losses of $66 000 000** for the province. It is for this reason that the Québec government stepped up its representations in Ottawa, demanding that the federal government respect the commitment made when the Supplementary Fiscal Equalization Payments Act was debated, hence claiming an additional amount of $66 000 000 in 1985-1986. However, on April 2, 1986, the federal Minister of Finance told Québec of his intention not to reopen this Act.

1 Allan J. MacEachen, *Fiscal Arrangements in the Eighties — Proposals of the Government of Canada*, November 1981, page 18.

2 Made in January 1985 (there are eight estimates for each fiscal year).

This is an unacceptable situation for Québec, for it is the only province that did not receive 95% of its equalization entitlements for 1984-1985, particularly since, under the supplementary payments legislation, Ottawa chose to grant $35 000 000 to two provinces, Newfoundland and New Brunswick, whose payments were to increase in any case in 1985-1986.

EQUALIZATION PAYMENTS
(in millions of dollars)

	1984-1985	1985-1986			Equalization in 1985-1986 compared with 1984-1985
		Formula[a]	Supplementary payments	Total	
Newfoundland	568	625	15	640	112.6%
Prince Edward Island	129	132	5	137	106.0%
Nova Scotia	620	571	20	591	95.3%
New Brunswick	531	600	20	620	116.7%
Québec	**3 074**	**2 744**	**110**	**2 854**	**92.8%**
Manitoba	479	420	50	470	98.1%

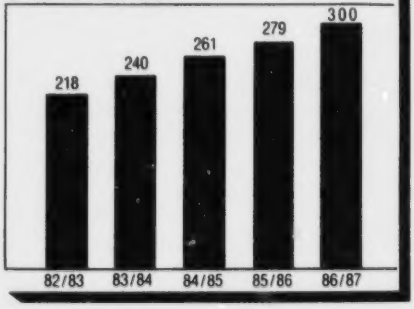
a Third federal estimate

Health and post-secondary education financing

The formula for the Established Programs Financing, which was drawn up in 1977 to provide global financing for health and higher education without matching the expenditures of the provinces in these sectors, has undergone three major changes since 1982.

The federal government began in 1982 by cutting the transfers to the provinces by an amount equivalent to 2% of the federal personal income tax. This put an end to the compensation for the revenue guarantee program that the federal government had granted the provinces in 1977 to make it possible to set up the new program for health and higher education financing.[1] This measure, which was strongly criticized by the provinces, will cost Québec, from 1982 to 1987, some $1 300 000 000 and for all the provinces, the loss will be close to $5 000 000 000.[2]

Québec's loss resulting from the withdrawal of compensation for the revenue guarantee: $1 298 400 000



EFFECTS OF 1982 WITHDRAWAL OF COMPENSATION FOR THE REVENUE GUARANTEE INCLUDED IN THE EPF
(in millions of dollars)

	Québec	All provinces
1982-1983	– 218	– 828
1983-1984	– 240	– 914
1984-1985	– 261	– 999
1985-1986	– 279	– 1 072
1986-1987	– 300	– 1 158
Total	**– 1 298**	**– 4 971**

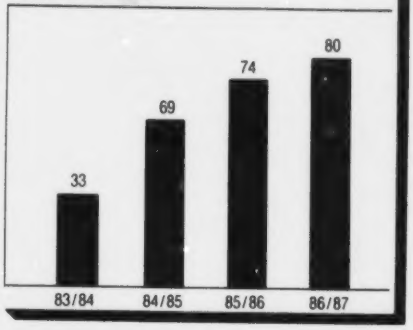
1 The Revenue Guarantee Program, set up in 1972 following the federal tax reform, was intended to protect the provinces against revenue losses resulting from this reform. This was in fact the role it played until 1977; but in that year the federal government decided to terminate the program, while agreeing to increase its contribution to the EPF by two personal income tax points by way of compensation. This compensation was granted to the provinces on condition that they agree to integration of the Hospital Insurance Program in the EPF in 1977.

2 Details of the federal cuts in the EPF for Québec and all provinces are appended.

Second, Parliament passed, on April 9, 1984, the Canada Health Act (Bill C-3) which provides for financial penalties for provinces that allow extra billing or require user fees, and allows the federal government to intervene in fee negotiations between provincial governments and physicians and dentists. This Act is a flagrant violation of the full exercise of provincial responsibility for health, in addition to running counter to the spirit of the EPF, which was to grant the provinces greater latitude in their areas of jurisdiction.

Finally, Bill C-12, passed on April 12, 1984, profoundly changed the philosophy of the EPF while reducing federal transfers. In effect, the federal government decided to split its global transfer between health and post-secondary education on the basis of the shared cost ratio in effect in 1975-1976;[1] the federal government thus claimed that it was financing more than 50% of higher education expenditures in the provinces and therefore concluded it was necessary to put a ceiling on the growth of its transfers for higher education (6% in 1983-1984 and 5% in 1984-1985). However, in so doing it revealed the fact that there was chronic underfinancing by the federal government in the health sector since provincial health expenditures were increasing more rapidly than its contribution. Overall, this operation, which repudiated the principle of global financing underlying the EPF, will have resulted in transfer cuts which, although applying for only two years, have effects on subsequent years. Thus, between 1983-1984 and 1986-1987, Québec will have suffered losses of $256 000 000 whereas the total savings realized by the federal government will be $984 000 000.

Québec's loss under the 6 and 5% program: $256 000 000



IMPACT OF THE 6 AND 5% PROGRAM
(in millions of dollars)

	Québec	All provinces
1983-1984	– 33	–125
1984-1985	– 69	–266
1985-1986	– 74	–285
1986-1987	– 80	–308
Total	**– 256**	**– 984**

Recurrent effects of past cuts

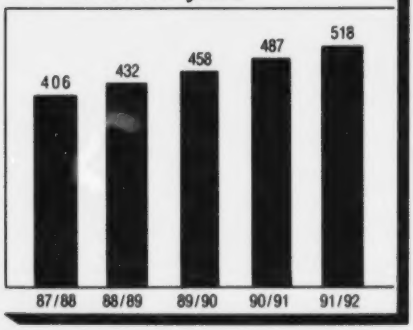
The cuts in transfers imposed by the federal government under the 1982-1987 fiscal arrangements will have extensive financial effects over the period of the 1987-1992 fiscal arrangements.

From April 1, 1987, the provinces receiving equalization payments will no longer benefit from the transitional guarantee or supplementary equalization payments. This means that the provinces will suffer the full impact of the formula introduced in 1982 if there is no substantial change in the coming talks on the fiscal arrangements. According to available information, it is estimated that Québec will from now on incur average revenue losses of some $200 000 000 per year compared to what it would have received under the formula in effect prior to 1982; this will even further accentuate the disparity in fiscal capacity between Ontario and Québec.

1 Year serving as the point of departure for calculating EPF payments and as the basis for the federal government's internal distribution of its budgetary envelopes for the departments of Health and Welfare (67.9%) and Secretary of State (32.1%).

In addition, the changes made in the EPF since 1982 will have increasing effects in the years to come. They will represent, for the five-year (1987-1992) fiscal arrangements, a total shortfall of $2 300 000 000 for Québec and close to $9 000 000 000 for the provinces as a whole.

Shortfall under the EPF of $2 300 000 000 over the next 5 years



RECURRENT EFFECTS OF TRANSFER CUTS IN THE EPF SINCE 1982
(withdrawal of compensation for the revenue guarantee, 6 and 5 % programs)
(in millions of dollars)

	Québec	All provinces
1987-1988	– 406	–1 572
1988-1989	– 432	–1 679
1989-1990	– 458	–1 787
1990-1991	– 487	–1 905
1991-1992	– 518	–2 031
Total	**–2 301**	**–8 974**

These figures show that the federal government will benefit from the effects of cuts made in the past, which will result in a reduction of $2 000 000 000 in 1990-1991 in transfers under the EPF. This was made possible by the federal government's decision to perpetuate the measures that the present Minister of Finance so roundly criticized in 1982.

"The only sign it [the federal government] shows of cutting spending is by shifting the burden of the established programs funding on to the provincial governments. The provinces are now moving into a deficit position, a position which will make it more difficult for them to finance this shift in spending... That is not co-operative federalism. That is predatory federalism and it will not and cannot work in this country."[1]

It hardly needs to be said that such an opinion respecting the reduction of transfers to the provinces was and continues to be that of Québec.

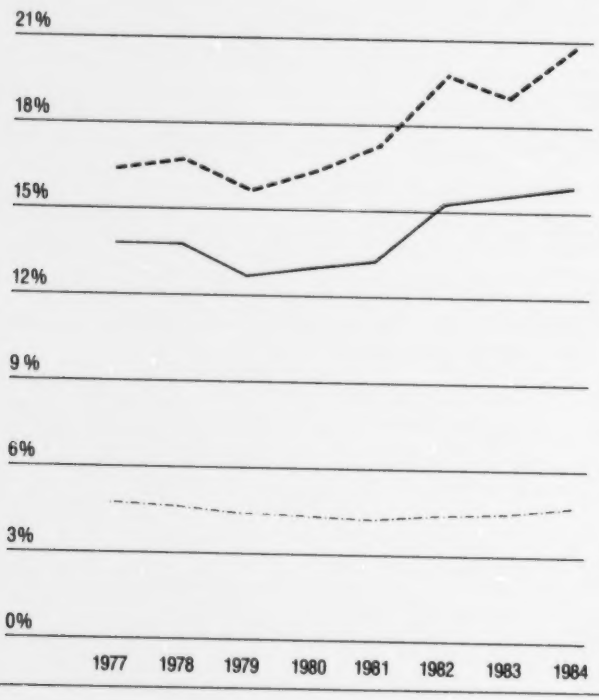
Transfers to the provinces are not the cause of the federal deficit

Although transfers to the provinces do indeed represent a substantial portion of federal expenditures (close to 20%), it is a remarkable fact that for several years their share of GNP has remained constant, while other federal expenditures have constituted an increasing proportion of GNP. In the years to come, this situation will remain the same if the federal government takes no further action, since, under the Act, equalization and EPF transfers are subject to ceilings tied to GNP.

In these circumstances, it is not reasonable for the federal government to attack an expenditure item over which it has supreme control in order to rationalize its expenditures. Past trends show that its efforts should be concentrated exclusively on other expenditures that it has not yet succeeded in bringing under control and whose share of GNP has increased considerably. The provinces will have been alone until 1984 in paying the costs of the cutback operation while the federal government has shown itself unable to put order into its own house.

1 Michael Wilson, *House of Commons Debates*, offical record, March 23, 1982.

FEDERAL TRANSFER TO THE PROVINCES AND OTHER FEDERAL EXPENDITURES AS PROPORTIONS OF THE GNP, 1977 to 1984



Source: National Income and Expenditure Accounts

Present federal government policies on fiscal arrangements

The federal government's approach

The federal approach to fiscal arrangements has unfortunately never been clearly stated. The provinces have no alternative but to rely on their interpretation of Ottawa's actions to understand the government's objectives. As a result, three observations can be made:

Federal approach: transfer of deficit to the provinces

- ☐ The federal approach: progressive transfer of the deficit to the provinces. Instead of opting for a global approach aimed at solving the various problems related to the fiscal arrangements simultaneously, the federal government prefers piecemeal action, the result of which is the transfer of its deficit to the provinces.

- ☐ The federal government has put aside genuine negotiations with the provinces on a significant portion of federal transfers; the premature and unilateral reopening of the EPF leaves no doubt on the matter.

☐ Cuts in the transfers to the provinces, a result of Bill C-96, would be made in such a way that eventually the federal government's financial contribution to the health and higher education sectors would decrease year after year beginning in 1988-1989.

Bill C-96

The federal government began reducing its transfers to the provincial governments, as from April 1, 1986, on the basis of Bill C-96, which was tabled in the House of Commons on February 14, 1986, by the Minister of Finance. This Bill proposes an amendment to the Fiscal Arrangements Act.

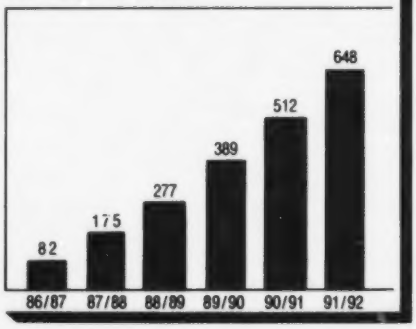
It is aimed at putting an end to the connection, established in 1977, between the changes in the federal contribution to the EPF and the growth of GNP. Since April 1, 1986, the increase in the federal contribution has been two percentage points lower than the growth of the economy, thus imposing on the provinces a cut that will increase over the years.

Bill C-96 guarantees the provinces that, should a recession occur, the total contribution to the EPF resulting from de-indexation would not increase at a rate lower than that of inflation. However, this guarantee is not sufficient to ensure that, in real terms, the federal per capita contribution would be maintained. In other words, the protection provided by Bill C-96 in the event of an economic recession does not even offer the minimum needed to cover changes in the provinces' needs, that is to say, the increase in prices and population.

Short-term financial effects of Bill C-96

If the Parliament of Canada adopted Bill C-96, the provinces would suffer an additional $2 000 000 000 cutback in 1990-1991. For Québec, this would mean a $512 000 000 cut for that year. Over the next six years, Québec would suffer a cutback of more than $2 000 000 000, and the provinces as a whole of more than $8 000 000 000.

A further shortfall of $2 000 000 000 for the EPF, for 1986 to 1992



Cuts of $6 000 000 000 in the EPF for Québec over a ten-year period

IMPACT OF BILL C-96
(reduction of transfers in millions of dollars)

	Québec	All provinces
1982-1987 fiscal arrangements		
1986-1987	– 82	– 317
1987-1988	– 175	– 677
1988-1989	– 277	–1 077
1989-1990	– 389	–1 517
1990-1991	**– 512**	**–2 004**
1991-1992	– 648	–2 542
1987-1992 fiscal arrangements	**–2 001**	**–7 817**
Total for 1986-1992	**–2 083**	**–8 134**

If it is adopted, Bill C-96 would further cut the federal contribution to health and higher education. This, in addition to the transfer reductions imposed by the previous federal government, would complete an impressive array of cuts totalling close to $6 000 000 000 for Québec over the 1982-1992 period. For the budgetary year which has just begun, the shortfall Québec should incur amounts to $462 000 000.

IMPACT OF EPF CUTS IN QUÉBEC
(in millions of dollars)

	Cuts by previous federal government	Cuts by present federal government	Total
1982-1983	– 219	—	– 219
1983-1984	– 273	—	– 273
1984-1985	– 338	—	– 338
1985-1986	– 359	—	– 359
1986-1987	**– 380**	**– 82**	**– 462**
1982-1987 fiscal arrangements	**–1 569**	**– 82**	**–1 651**
1987-1988	– 406	– 175	– 581
1988-1989	– 432	– 277	– 709
1989-1990	– 458	– 389	– 848
1990-1991	– 487	– 512	– 999
1991-1992	– 518	– 648	–1 165
1987-1992 fiscal arrangements	**–2 301**	**–2 001**	**–4 302**
1982-1992 Total	**–3 870**	**–2 083**	**–5 953**

Long-term financial effects of Bill C-96: Contracting-out by the federal government?

To fully understand the scope of the reductions planned by the federal government, they should be compared to the financial transfers paid under the EPF. The following table presents the estimated transfer payments to Québec for health and higher education, divided between these two sectors according to federal methods, and the financial impact of Bill C-96. First, it is clear that the financial transfers received by Québec for the EPF would start decreasing from one year to the next as of 1988-1989.[1] Second, it becomes evident that when the next fiscal arrangements end, in 1991-1992, the federal government will reduce its transfers to Québec by an amount larger than its financial contribution to higher education. **This means that the federal government would have, within a six-year period, stopped paying the equivalent of its financial contribution to higher education, without having explicitly announced its intention publicly and without having negotiated the financial and legislative terms and conditions of that withdrawal with the Québec government.**

1 The financial transfers received by Québec are calculated by deducting from the value of the total federal contribution the value of the tax points allocated to it in the past. Since the total contribution would increase at a slower rate as a result of de-indexation, while the value of the tax points generally increases at the same rate as the economy, it is easy to understand that the financial transfer, which is obtained by calculating the difference between the two, stops increasing and rapidly begins a negative growth pattern.

CHANGES IN TRANSFER PAYMENTS TO THE EPF AND CUTS ANTICIPATED ON THE BASIS OF BILL C-96
Québec (in millions of dollars)

	Estimated transfer payments[1] (without cuts)				
	Health[2]	Higher education	Total	Impact of Bill C-96	Anticipated transfer payments after cuts
1986-1987	1 522	498	2 020	– 82	1 938
1987-1988	1 600	519	2 119	–175	1 944
1988-1989	1 654	529	2 183	–277	1 906
1989-1990	1 707	538	2 245	–389	1 856
1990-1991	1 767	549	2 316	–512	1 804
1991-1992	1 820	556	2 376	–648	1 728

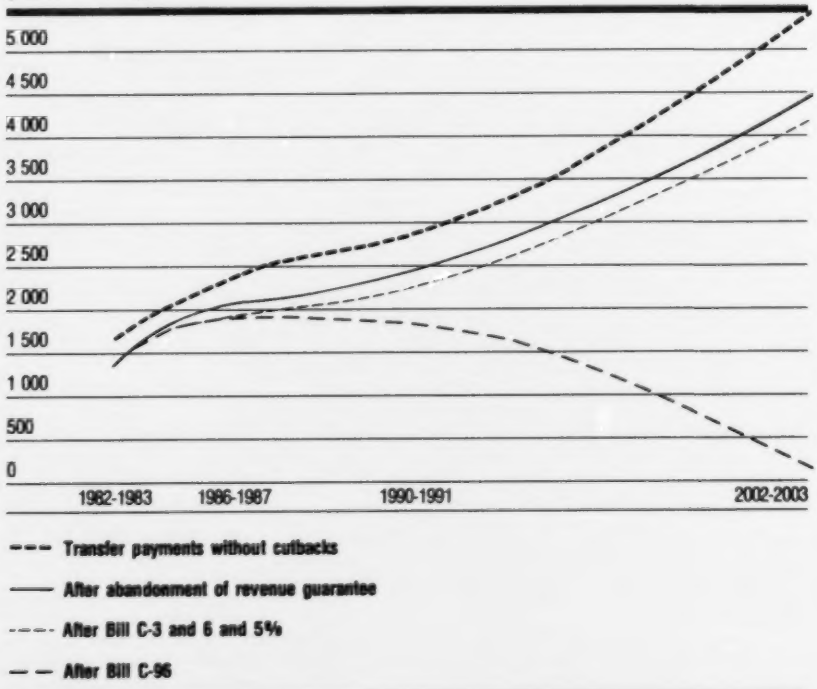
1 Divided between health and higher education according to the internal distribution method used by the federal government for the budgetary envelopes of the federal departments of Health and Welfare and Secretary of State.

2 Includes extended health care services.

2003: end of federal financial contribution to health and higher education

Furthermore, it is remarkable to note that Bill C-96 has no provision to end the de-indexation of the EPF. If it should be extended after 1990-1991, and that would mean after the $2 000 000 000 cutback objective set by the federal government, a long-term mechanical estimate shows that the amount withheld from Québec would increase exponentially. As a result, in 2003, the federal government's financial contribution to Québec's health and higher education programs will have totally disappeared. Thus, after having in fact abandoned its financial participation in higher education after six years of partial de-indexation of the EPF, the federal government could, by maintaining the measure for eleven more years , also withdraw from the financing of Québec's health programs.

IMPACT OF FEDERAL EPF CUTS
Québec
(millions de $)



Although the Québec government is, in principle, in favour of federal withdrawal from certain sectors, it cannot accept this withdrawal without negotiation with the provinces and especially without compensation in the form of a fiscal transfer. In addition, it would be paradoxical for the federal government to withdraw financially from those sectors while imposing national standards and applying financial penalties whenever the provinces do not comply with these standards (Bill C-3).

Inconsistency of federal government budget choices

New federal tax expenditures financed by cuts in health and higher education

The federal Minister of Finance justifies the cuts under Bill C-96 by the simple fact that transfers to the provinces are an appreciable part of federal expenditures and, as such, cannot be excluded from budget cuts. However, in the same budget where he announced his wish to reduce the deficit and cut $2 000 000 000 annually from his financial contribution to health and higher education programs by 1990-1991, the federal Minister announced a progressive exemption of capital gains which will deprive the federal Treasury of $1 400 000 000 in 1990-1991, an amount equal to 70% of the estimated savings in such priority sectors as health and higher education! In addition, in that same May 1985 budget, the federal government promised to gradually stop taxing oil and gas in producing provinces. The federal Minister of Finance estimated that, in 1990-1991, this withdrawal would represent some $3 900 000 000, which is roughly twice the amount of the cuts in the health and higher education sectors!

In view of these recent choices and ministerial statements to the effect that the provinces should not expect a substantial enrichment in equalization entitlements, one wonders if the federal government is not in the process of giving up its role in redistributing Canada's wealth and reducing interprovincial disparities as regards public services.

Worsening of interprovincial disparities

The federal Minister of Finance maintained that the EPF cuts are fair because each province would have to support the same per capita burden. Such an assertion does not, however, take into account that a one-dollar cut per capita in a rich province does not have the same impact as an equivalent cut in a less affluent province.

Federal cuts will accentuate interprovincial disparities

The rich provinces have several characteristics which allow them to absorb more easily any reduction in federal transfer payments. It is important to remember, for instance, that these provinces have a high fiscal capacity which gives them more latitude to levy taxes. As for expenditures, the richer provinces have less social aid or, more generally, income security needs to support.

On the contrary, Québec's financial situation is a major cause for concern and the demonstration by Québec's Minister of Finance in his **Québec's Public Finances: The Need for Immediate Action** leaves no doubt in that respect. The high, persistent deficits which, if no major steps had been taken to reduce expenditures, would have exploded in the next few years, leave Québec with a limited capacity to absorb new federal cuts.

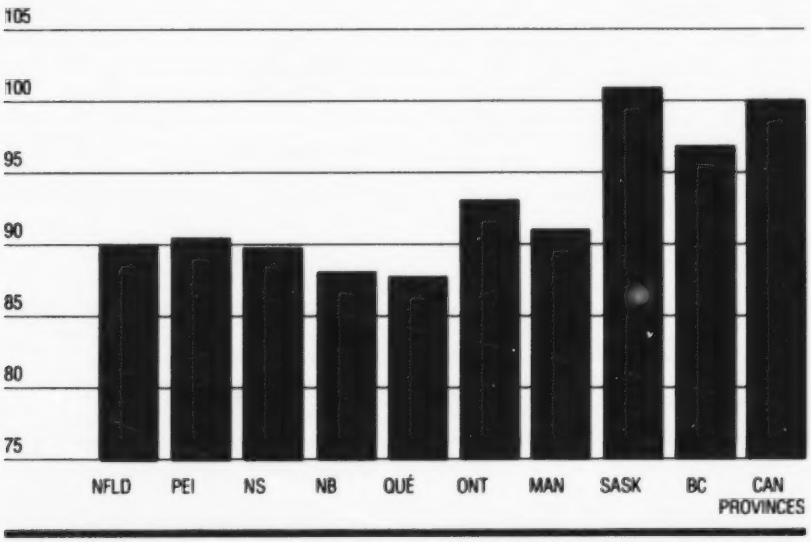
Such disparities still exist in Canada because the role played by the equalization program is not satisfactory. Not only does it not make it possible to adequately reduce the gap in the fiscal capacities of the provinces, but it also implicitly assumes that public service needs are the same, per capita, everywhere in Canada. Although such may be the case as far as health and higher education expenditures are concerned, it is certainly not so when it comes to income

security programs whose costs are shared with the federal government.[1] Of the ten provinces, Québec is the one which must shoulder the heaviest per capita burden for this expenditure item. This phenomenon is caused mainly by the effects of long periods of unemployment, which mean that the probability of an unemployed person resorting to social aid is higher in Québec than in any other province.

Even though the federal government pays 50% of those costs, under the Canada Assistance Plan (CAP), Québec's burden is still much heavier to bear, per capita, than in the other provinces. An interprovincial comparison has shown that by adjusting the tax burden, and by including in revenue the federal transfers under the equalization program, the EPF and the CAP, Québec has the lowest capacity to offer public services, once the cost of income security is assured.

INDEX OF THE PROVINCES' CAPACITY TO PROVIDE PUBLIC SERVICES OTHER THAN INCOME SECURITY (1985-1986)

(Canada = 100)



Note: Alberta was not included in this graph in order to better illustrate the disparities among the other provinces (Alberta's capacity index is 179.7)

This situation was created by equalization program shortcomings and by the inadequacy of federal funding for provincial income security programs. Consequently, Québec must either increase its tax burden, or its debt, or reduce the number or quality of its other public services. That constitutes an inequity in the system of transfers to the provinces which should be corrected by an adequate equalization mechanism, while the cuts resulting from Bill C-96 will only increase interprovincial disparities. This comes as no surprise since the federal government prefers a mechanical approach intended not so much to solve the problems of the less affluent provinces as to rid itself of part of its deficit at the expense of all of the provinces, without distinction of each province's capacity to absorb such cutbacks.

1 Social aid, legal aid, health assistance and the administration of these programs.

Consequences of Bill C-96 for Québec government budget choices

If the federal government persists in its intention, Québec's public finances will be put in a very difficult position: on the one hand, health and post-secondary education expenditures will increase rapidly, much faster than the rate of inflation, and on the other, transfer payments to the EPF will be reduced as early as 1988-1989.

As regards expenditures, several factors will contribute to a major increase in budget allocations for health and higher education. In the health sector, new and expensive, but indispensable, technologies will have to be implemented. In addition, the special needs of the elderly will have to be taken into account as this segment of the population is increasing by 3% annually while the total population is increasing by only 0.5% each year. In the post-secondary education sector, Québec must meet new challenges in greater specialization for advanced trade techniques related to technological progress, as well as opening doors to an ever growing part-time student population, which reflects Québec's new retraining needs.

In view of such considerations, the study group on health,[1] reporting to the task force headed by Canada's Deputy Prime Minister recommended that transfers for health programs be maintained in full. On page 13 of that report, we read: "**... based on this review, the study team concludes that there are no compelling program reasons to reduce transfer payments.**"

Therefore, the various options available to the Québec government must be studied if the equation of the inevitable increases in health and higher education costs, the proposed reduction of federal transfer payments to the EPF and the need to reduce the budget deficit is to be resolved.

In the overall analysis of Québec's public finances, two solutions seem plausible: the reduction of expenditures and an increase in user fees for certain public services. However, in the health sector, these two possibilities offer little hope because needs increase constantly and the application of user fees is prohibited by the Canada Health Act (Bill C-3), under risk of financial penalty.

In the short run, the government has no other alternative but to resort to taxation. Consequently, since the federal government:

- ☐ **maintains the transfer payment reductions imposed since 1982, which means an estimated loss of $380 000 000 in 1986-1987 for Québec,**
- ☐ **refuses to pay the sum of $66 000 000 to Québec under the equalization program,**
- ☐ **has already begun slashing transfer payments to the provinces by virtue of Bill C-96, thus reducing transfer payments to Québec by $82 000 000 in 1986-1987,**

1 *Health and sports program: a study team report to the task force on program review*, November 1985, Government of Canada.

Québec must increase taxes because of federal cuts

the Minister of Finance has announced that the Québec government is forced to levy a surtax on business firms to compensate for the Québec Treasury's shortfall. This surtax, which the government is forced to levy as a result of federal cuts, will however be reconsidered if the federal government meets its commitments as regards equalization, withdraws Bill C-96, and agrees to begin negotiations with the provinces with a view to arriving at an equitable solution by March 31, 1987, at the time the current fiscal arrangements expire. If that were not to happen, the repercussions of de-indexation of transfer payments to the provinces would be such that the situation would have to be re-examined for 1987-1988.

Québec's approach to federal-provincial financial relations

Fiscal arrangements: solution by consensus

The approach to the fiscal arrangements favoured by the Québec government is one of consensus. To achieve this, certain principles with regard to financial relations must be observed by the two orders of government. Québec is therefore proposing the outline of a solution which could serve as a basis for federal-provincial negotiations and which respects both the principles that must be observed in any revision of transfers to the provinces and the financial limitations of the federal government and the have-not provinces.

Basic principles to be respected

— Respect for expiry dates

"Taking the action of unilaterally cutting the financing, which the government is now proposing, and then having some discussions with the provinces, surely puts the cart before the horse. We should be reversing this procedure."[1]

Québec of course shares this opinion, put forward during the discussions on the present fiscal arrangements, which should rule out their premature reopening. Since they expire on March 31, 1987, nearly one year remains to the federal government and the provinces to renegotiate them, in good faith, and to find a compromise that would satisfy the parties.

— Respect for the Constitution

The Canadian Constitution clearly establishes both the objectives of the equalization program and the jurisdictions of the provinces in matters of health and education. The Québec government is of the opinion that any change in the fiscal arrangements should be made with a view to reducing disparities between the provinces and showing greater respect for provincial fields of competence.

— Limiting the federal government's power to act unilaterally

Despite the importance of the federal transfers for provincial public finances and the influence they exert on the very fabric of the Canadian federation, several of these programs are governed by federal legislation only, and the Parliament of Canada can therefore change them at will. Also, in most cases federal legislation contains no rules on procedures for negotiation, amendment or interpretation of the laws and regulations governing these programs. In the past this state of affairs resulted in a number of situations in which the provinces were obliged to abide by unilateral federal decisions without any voice in the proceedings, even though — and this was fairly often — the programs in question came under provincial jurisdiction.

1 Michael Wilson, *House of Commons Debates*, official report, March 24, 1982

It therefore seems essential that the federal government and the provinces give serious consideration to setting up a formal framework more likely to produce a consensus on the conduct of financial relations. Such a framework should assure the provinces, for a predetermined period, stability and predictability in transfer payments, an indispensable prerequisite to efficient management of the provinces' financial frameworks.

The Québec government is therefore reiterating a request it has already had occasion to make to the federal government, the objective of which is to institute a new era in federal-provincial financial relations. **The Québec government believes that real fiscal arrangements between the federal government and the provinces should be preceded by a formal agreement between the two orders of government, which would give these arrangements a more permanent, more stable, and less arbitrary character than they have at present.**

— Financial resources geared to provincial responsibilities

Through use of its spending power in provincial fields of jurisdiction, and by setting up a cost-sharing mechanism, the federal government made a commitment to the provinces to share financially in establishing a free universal health care system and offering readier access to higher education. This federal measure was made possible by access to fiscal resources higher than those of the provinces.

Since the federal government chose to make transfer payments to the provinces rather than allocate to them a taxation field sufficient to meet their constitutional responsibilities in matters of health and higher education, it should now respect its financial commitments.

The resources allocated to the provinces must therefore be adequate to allow them to respect the principles of universality, accessibility and free service, which have prevailed at the inception of the programs and which are to be found principally in the Canada Health Act.

In addition, equalization payments must be high enough to allow the have-not provinces to offer a level of services comparable with the other provinces, without having to resort to greater taxation.

— Respect for the provinces' budgetary choices

One of the improvements brought about by the creation of the EPF in 1977 was global financing for health care and higher education. Whereas before each sector had its own cost-sharing program, the EPF provided greater flexibility for the provinces in allocating to health and post-secondary education a transfer that kept pace with the rate of economic growth. Inherent in this greater independence of provincial spending from federal transfers was recognition of provincial jurisdictions in these sectors.

However, Bill C-12 totally repudiated this principle, since the federal government decided unilaterally on a division of its transfers between health and higher education (on the purely arbitrary basis of its transfers in 1975-1976); in this way it procured the means to judge the choices of the provinces and, in some cases, to impose financial penalties. Moreover, Bill C-3 constitutes an attack on provincial jurisdiction in matters of health since national standards have to be followed or a financial penalty is incurred, and it enables the federal government to interfere in fee negotiations between the provinces and physicians and dentists. Overall, notwithstanding federal commitments made at the time

of its adoption, and despite the hopes raised by such a formula, over the years the EPF program has paradoxically become more restrictive than previous cost-sharing formulas.

Consequently, the Québec government believes that federal transfers should obey the principle of flexibility. This would be an inexpensive way for the federal government to respect the provinces' budgetary options and to return to the spirit prevailing at the inception of the EPF in 1977.

— Global negotiations

The Québec government feels that the negotiations on federal transfers should concern three main programs: equalization, the EPF and the CAP, so that the provinces could obtain an overall picture of the objectives of the federal government and the negotiations could deal with possible reallocation of funds to the programs. But instead we see piecemeal action, limiting the possibilities of a solution.

Proposal for transfer programs

Québec proposes an equitable, negotiated solution

Faithful to the principle of global negotiations, the Québec government suggests a means to eliminate disagreement between the provinces and the federal government. This approach, which must be considered in its entirety, has one prerequisite: **the federal government must put back by one year its action with regard to the EPF and real federal-provincial negotiations must be opened as soon as possible on the basis of Québec's proposal or any other proposal aiming at a compromise.**

— Equalization

Québec believes that the major interprovincial imbalances that exist at the present time in the capacity to offer public services as well as in taxation levels must be corrected by improving the equalization program so that the fiscal capacities of the recipient provinces approach that of Ontario. Québec admits, however, that the way in which this is done must take the federal government's financial constraints into account.

Consequently, the Québec government considers that the equalization program should be changed as of April 1, 1987 and that the new formula adopted should provide for a means to further reduce the differences in fiscal capacity of the recipient provinces as compared with that of Ontario.

— Canada Assistance Plan

The matter of interprovincial disparities consequent upon the fairly heavy burden of the provincial income security programs has already been discussed. The problems related to the existence of a uniform federal contribution rate throughout the country (50% for CAP) have been known for years and it has been suggested many times that this rate should vary in terms of the income security needs of each province. The most recent request in this sense came from the Federal Parliamentary Task Force on Fiscal Arrangements between the federal government and the provinces, in its 1981 report. On page 149 of the report the task force recommended that:

"fiscal arrangements recognize interprovincial differences in cost arising from differing levels of need for social assistance payments to individuals."

In this respect, the task force reviewed certain indicators of provincial needs related to the economic situation, the organization of the labour market or the average personal income.

Consequently, the Québec government proposes that the funding of provincial income security programs be amended in accordance with the recommendations of the Parliamentary Task Force on Fiscal Arrangements. Work should be begun as soon as possible to define an acceptable indicator of the needs of each province in matters of income security; a program should then be set up, for April 1, 1987, to rectify present interprovincial disparities.

— Financing health and post-secondary education

In the Québec government's view, the federal government's deficit must not be dealt with, in the medium term, by simply abandoning all financial transfers for health and higher education. Québec also opposes the federal government's continuing to set standards for health programs and, perhaps, new constraints in the post-secondary education sector, as a concomitant of its financial contracting out.

Under these circumstances, Québec feels that, since the federal government wishes to free itself of the deficit incurred from the financing of these programs, it is only reasonable for the provinces, which want to do so, to fully assume their constitutional responsibilities in these sectors. This can only be achieved by a fiscal transfer, which would mean federal withdrawal from the funding of programs covered by the EPF.

The Québec government believes, therefore, that if the federal government abandons responsibility for health and post-secondary education programs financing, it must withdraw from these sectors by means of compensation in the form of additional tax points.

This procedure is totally in keeping with the spirit of the recommendations of the federal task force which has just made its report to the Deputy Prime Minister on the subject of health. On page 72 of this report we read:

"This would involve, inter alia, partial federal disengagement from financial or direct substantive influence on provincial illness-treatment plans, leaving the provinces, to the fullest extent possible, reponsible for raising revenues for and cost control of their health insurance systems."

The technical aspects of such a withdrawal could be discussed by the federal and provincial governments between now and the end of the present fiscal arrangements. The extent of the taxation field to be allocated to the provinces could be determined by the parties involved as these negotiations unfold, allowing the provinces which wish to, to fully assume their constitutional responsibilities in the health and post-secondary education sectors.

Conclusion

Québec favours a joint approach to the matter of deciding on the most rational way of handling federal transfers to the provinces. It therefore strongly objects to the unilateral, mechanical approach advocated in Bill C-96, which would increase interprovincial disparities and destabilize Québec's public finances.

But since the federal government has already decided to reduce its transfer payments as of April 1, 1986, on the basis of Bill C-96, and still refuses to pay $66 000 000 in equalization transfers, the Minister of Finance has announced that the Québec government must impose a surtax on business firms to make up for the treasury's losses. Given the dynamics of the de-indexation of transfer payments, the Québec government will have to re-examine the situation in 1987-1988.

If the federal government agreed to honour its commitment with regard to equalization and withdraw Bill C-96, negotiations could be undertaken in good faith with a view to revising the main transfer programs, to the satisfaction of both orders of government, for April 1, 1987. To this end Québec suggests a global approach which would respect certain principles for determining federal-provincial financial relations, constituting a reasonable compromise. Such a solution has three aspects:

- **The federal government must improve the equalization program so that the fiscal capacities of the have-not provinces more closely approach that of Ontario.**

- **The federal government must adopt a formula for contributing to the cost of provincial income security programs on the basis of provincial needs.**

- **The federal government must maintain an acceptable financial contribution or cease its funding of health and post-secondary education by means of compensation in the form of additional tax points.**

Finally, the Québec government believes that a formal agreement between the two levels of government is the only way to make the fiscal arrangements more permanent, more stable and less arbitrary than at present.

SUPPLEMENTARY INFORMATION

IMPACT OF FEDERAL CUTS IN EPF IMPOSED SINCE 1982

IMPACT OF CUTS IN EPF
(in millions of dollars)
QUÉBEC

	1982-83	1983-84	1984-85	1985-86	1986-87	Total 1982-87	1987-88	1988-89	1989-90	1990-91	1991-92	Total 1987-92	Total 1982-92
Cuts made by previous federal government													
Withdrawal of compensation for revenue guarantee (1982-1983)	−218.4	−239.9	−260.9	−278.9	−300.3	**−1 298.4**	−320.9	−341.4	−362.2	−384.8	−408.8	**−1 818.0**	**−3 116.4**
6% and 5% (1983-1984 and 1984-1985)	—	−32.8	−69.4	−74.2	−79.9	**−256.2**	−85.3	−90.8	−96.3	−102.3	−108.7	**−483.4**	**−739.7**
Bill C-3 (1983-1984)	—	—	−7.9	−6.1	—	**−14.0**	—	—	—	—	—	—	**−14.0**
Total	−218.4	−272.7	−338.1	−359.1	−380.2	**−1 568.6**	−406.2	−432.1	−458.5	−487.1	−517.5	**−2 301.4**	**−3 870.0**
Cuts planned by the Conservative government													
Bill C-96 (1986-1987)	—	—	—	—	−82.3	**−82.3**	−174.9	−277.2	−389.2	−512.4	−647.6	**−2 001.3**	**−2 083.6**
Total cuts													
Compensation for revenue guarantee, 6% and 5%, C-3, C-96	−218.4	−272.7	−338.1	−359.1	−462.5	**−1 650.9**	−581.1	−709.3	−847.6	−999.6	−1 165.2	**−4 302.8**	**−5 953.6**

Indications to the contrary notwithstanding, it is assumed that all the provinces will comply with Bill C-3 as of 1986-1987.

IMPACT OF CUTS IN EPF
(in millions of dollars)
ALL PROVINCES

	1982-83	1983-84	1984-85	1985-86	1986-87	Total 1982-87	1987-88	1988-89	1989-90	1990-91	1991-92	Total 1987-92	Total 1982-92
Cuts made by previous federal government													
Withdrawal of compensation for revenue guarantee (1982-1983)	−827.9	−914.3	−999.0	−1 071.5	−1 158.1	**−4 970.7**	−1 241.8	−1 325.9	−1 411.6	−1 505.0	−1 604.6	**−7 088.8**	**−12 059.5**
6% and 5% (1983-1984 and 1984-1985)	—	−125.1	−265.7	−284.9	−308.0	**−983.6**	−330.2	−352.6	−375.4	−400.2	−426.7	**−1 885.1**	**−2 868.7**
Bill C-3 (1983-1984)	—	—	−85.6	−107.3	—	**−192.9**	—	—	—	—	—	—	**−192.9**
Total	−827.9	−1 039.4	−1 350.3	−1 463.7	−1 466.0	**−6 147.3**	−1 572.0	−1 678.5	−1 786.9	−1 905.2	−2 031.3	**−8 973.8**	**−15 121.1**
Cuts planned by the Conservative government													
Bill C-96 (1986-1987)	—	—	—	—	−317.4	**−317.4**	−676.8	−1 076.7	−1 516.9	−2 004.2	−2 541.8	**−7 816.4**	**−8 133.8**
Total cuts													
Compensation for revenue guarantee, 6% and 5%, C-3, C-96	−827.9	−1 039.4	−1 350.3	−1 463.7	−1 783.4	**−6 464.6**	−2 248.8	−2 755.2	−3 303.8	−3 909.4	−4 573.1	**−16 790.2**	**−23 254.9**

Indications to the contrary notwithstanding, it is assumed that all the provinces will comply with Bill C-3 as of 1986-1987.